DISTRICT OF COLUMBIA BOND AUTHORIZATION LEGISLATION

HEARINGS

BEFORE THE

SUBCOMMITTEE ON GOVERNMENTAL EFFICIENCY AND THE DISTRICT OF COLUMBIA

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 744

TO AUTHORIZE THE DISTRICT OF COLUMBIA TO ISSUE AND SELL GENERAL OBLIGATION BONDS FOR THE PURPOSE OF PAYING CERTAIN LIABILITIES OF THE DISTRICT, AND FOR OTHER PURPOSES

JULY 14 AND SEPTEMBER 29, 1981

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DISTRICT OF COLUMBIA BOND AUTHORIZATION LEGISLATION

TUESDAY, JULY 14, 1981

U.S. SENATE, SUBCOMMITTEE ON GOVERNMENTAL EFFICIENCY AND THE DISTRICT OF COLUMBIA, COMMITTEE ON GOVERNMENTAL AFFAIRS,

Washington, D.C.

The subcommittee met, pursuant to notice, at 9:45 a.m., in room 6202, Dirksen Senate Office Building, Hon. Charles McC. Mathias, Jr. (chairman of the subcommittee) presiding.

Present: Senator Mathias.

Staff present: Bill Leonard, staff director; Eileen Mayer, chief counsel; Margaret Crenshaw, minority chief counsel; Christine Sarcone, chief clerk; and Phil Ward, legislative assistant to Senator Rudman.

OPENING STATEMENT OF SENATOR MATHIAS

Senator MATHIAS. The committee is in order.

This morning the Subcommittee on Governmental Efficiency and the District of Columbia begins a series of hearings to consider S. 744, a bill which I introduced at the request of the Mayor to authorize the District of Columbia to issue and sell general obligation bonds for the purpose of paying certain liabilities of the District.

The first full audit of the District of Columbia's books, issued in February of this year, resulted in an unqualified opinion based on generally accepted accounting principles.

It also showed, however, that as of September 30, 1980, the city faced a $388 million accumulated deficit. The city states that $184 million of that accumulated deficit represents its immediate cash needs. S. 744 would allow the District to enter the bond market to fund these cash needs.

It seems inconceivable today that when Congress enacted the Home Rule Act in 1973, it acted without a full understanding of where the city stood financially. No audit was performed. In fact, the city's books were—as we have since discovered—in an unauditable condition. Only now, 6 years into home rule, do we finally have a clear financial picture.

Today, we realize that some of the steps the city was forced to take en route to self-government, including the application of generally accepted accounting principles, have been largely responsible for throwing the city's books out of balance.

We were all pleased to learn last Friday that the city projects up to a $7 million budget surplus for fiscal year 1981. A balanced

budget for fiscal year 1981 and beyond is essential to the long-term fiscal health of the city and to its successful entry into the bond market.

I would like to take this opportunity to congratulate Mayor Barry in person for this accomplishment.

Now the city and the Congress must act to eliminate the accumulated deficit. The Mayor has proposed the approach embodied in S. 744. The city is to be commended for meeting the problem head on and for moving to deal with the accumulated deficit before it results in a much more serious financial impact on the city.

As we proceed with hearings on this measure, questions will be raised about the propriety of using the bond market to finance an operating deficit and the effect that such a bond issue will have on the city's long-term fiscal health.

In future sessions we hope to hear from a variety of witnesses, ranging from bonding experts to city residents. In the end, I am confident that the subcommittee and the city leaders can reach a viable solution to meet the cash needs of the city and move it expeditiously through the Senate.

Before we proceed to Mayor Barry, I would like to insert in the record Senator Eagleton's statement on this subject.

Without objection, so ordered.

[The opening statement of Senator Eagleton follows:]

OPENING STATEMENT OF SENATOR THOMAS F. EAGLETON

Mr. Chairman, as we begin consideration today in the Senate of S. 744—a bill which would authorize the District of Columbia to issue and sell general obligation bonds for the purpose of paying off some of the City's $388 million accumulated deficit—I hope we document the City's needs and at the same time clarify for the record the serious, on-going financial problems which the City must confront.

My initial inclination is to extend the City this helping hand. I believe this bonding authority is a tool which should be available to the District, as it is to many cities and states. Connected with such an authorization, however, are a number of hard questions.

First, I hope the witnesses can explain why this method of financing represents the City's best, and perhaps only, course of action. It has been suggested that the City sell excess property, charge more for RLA land sales, increase taxes, and cut expenditures; thus, raising additional capital. It has also been suggested that the City seek authorization to continue short-time borrowing from Treasury—with or without interest—and retire the debt over a five- or seven-year period directly from revenues.

Second, will the City's entry into the long-term bond market solve the City's financial problems? I was delighted to read in Saturday's newspapers that the City now projects a $7-million surplus for fiscal year 1981. Nonetheless, I must question whether the City can maintain present services and carry an increase in its present debt service, when I review the current bond market, the increasing costs of municipal operations, cutbacks in Federal aid to urban areas, deterioration of infrastructures, and the high tax burden already placed on District residents.

As many of you know, I have long felt that the City's payroll far exceeds the needs of its 637,000 residents. I have made numerous comments to that effect in earlier hearings and in letters to city officials. Despite the U.S. Census Bureau study released recently by the Mayor, I continue to regard 40,000 municipal employees as far too many for the District, regardless of its multiple role of city, county, and state.

Other District observers have other favorite areas for cost cutting or for increasing revenue-close schools, increase estate taxes, cut back the university, halt capital construction projects, et cetera. Sooner or later the City may have to review and implement many of these suggestions simply to maintain a balanced budget.

As they relate to the bonding authority, why should these proposals not be initiated now, either in lieu of the bonding authority or as part of a financial planning package which would include bonding as well as the other suggestions?

Third, I have some questions about the bill itself. I am not convinced that authorizing the sale of general obligation bonds to erase an accumulated deficit—mortgaging the future to pay for the sins of the past—should be encouraged for any municipality or State.

Further, if Congress does approve this method of financing for the District, I, like the General Accounting Office, am not sure it should be for the full amount—$184 million—or for the full term—30 years—sought by the City.

Nor am I sure that Congress, or more appropriately the City Council, should authorize these bonds without requiring a referendum on the issue. I understand that other jurisdictions seeking bond financing to retire accumulated deficits requested a shorter authorization, perhaps 10 to 20 years, and I further understand that most States consider long-term indebtedness so serious that 15 States require a constitutional amendment prior to incurring a long-term debt. Eighteen States require ratification by referendum, and 17 require authorization by the State legislature, many with stringent requirements such as a three-quarter vote.

Also, I understand that long-term municipal or State debts are usually incurred for capital projects, not for operating expenditures.

I hope witnesses can make a strong case for the deviations S. 744 makes in what appears to be standard bonding practice in other jurisdictions. Otherwise, amendments in these provisions may be advisable.

Despite all these very real concerns, there is one fact of life which cannot be overlooked. In my view, the circumstances dictate that Congress give every presumption of listening to the City's plan. Until six years ago, Congress ran the City. When Congress approved Home Rule, we launched the new ship of state with practically no review of the City's financial affairs, discovering only a year after Home Rule took effect that the City's books and records were unauditable.

Through the Temporary Commission on Financial Oversight, Congress has attempted to rectify the financial management operations and auditability of the City, and the joint efforts have produced great progress. However, when the first audits revealed the massive accumulated debt facing the District, Congress did not step forth and offer to erase the portion incurred prior to Home Rule—a sum estimated by Lazard Freres to be nearly $180 million, almost the sum sought in S. 744.

Given this history, as James Lynn, Federal City Council President and former OMB Chief, testified in the House: "If Congress does not choose to solve the problem in one or more direct ways . . . then such a sale ought to be authorized." I do not see Congress addressing the City's accumulated deficit in direct ways—a cash appropriation, authority for a non-resident income tax, an increase in the Federal payment above the $36.6 million now proposed.

This bonding proposal must be evaluated and appreciated in this light. It is to the City's credit—and to yours, Mr. Mayor—that the City never sought direct congressional aid. The City has accepted the political realities and in the true spirit of Home Rule has prepared to shoulder the accumulated debt itself.

I will support you, and I wish you luck, but I urge you to provide all possible information on why S. 744 will work now and why it will not place a crippling burden on the City in the future.

Senator MATHIAS. We are pleased to welcome Mayor Marion Barry as our first witness today. Mayor Barry, you may proceed with your testimony.

TESTIMONY OF MARION S. BARRY, JR., MAYOR, WASHINGTON, D.C., ACCOMPANIED BY ELIJAH ROGERS, CITY ADMINISTRATOR, WASHINGTON, D.C.

Mayor BARRY. Thank you, Mr. Chairman.

I have a prepared statement which I would ask be placed in the record in its entirety.

Senator MATHIAS. Without objection, so ordered, and it will be placed in the record following your testimony.

Mayor BARRY. It is always a pleasure to appear before this subcommittee chaired by the distinguished Senator from our neighboring State of Maryland.

The chairman has been a strong supporter of the District and we certainly appreciate your continuing support. We look forward to many fruitful sessions and legislative approaches with you.

Mr. Chairman, I would also like to express my appreciation for the rapid scheduling of hearings on Senate bill 744.

With me is Mr. Elijah Rogers, the City Administrator of the District of Columbia We have a number of other officials in the room who, if necessary, may come forward for any specific questions.

As you know, all over America we find cities with severe financial problems—Boston, Detroit, New York, Newark, Cleveland, Chicago, Buffalo, and others. And now Washington.

As you know, Mr. Chairman, our Nation's cities must cope with the overwhelming burdens of deficient tax bases, joblessness, high crime rates, drugs, public housing, public assistance, and a vast array of other social problems.

As you indicated, we have tried very hard to get on top of our financial problems of budget. Unlike other cities such as Baltimore and others, we have no State governments to turn to. Therefore, we have to do our own the best we can under the circumstances.

As you know, Mr. Chairman, two-thirds of the District's land is tax exempt, two-thirds of the income earned by the District is tax exempt, the Federal payment, which we all agree on, is too long. It ought to be $641 million as opposed to $300 million. I could go on and on.

We have tried to look at the previous sins where we have accumulated a large deficit. We have tried this before home rule and some since home rule. As you indicated in your statement, that deficit is $388 million.

We got into this situation because the District was on a cash basis of accounting. It meant that the District could defer large and steadily increasing sums of accounts payable into future years instead of technically having a balanced budget.

Quite frankly, Mr. Chairman, we could have continued such financial practices and added to this deficit. We could have postponed the day of reckoning to some future years.

In concert with the Financial Oversight Commission, of which you were a member, I chose instead to confront the record of the District's inadequate budget practices. The fiscal 1981 budget was my first opportunity to shape a different budget, a budget that was fully balanced and generally accepted accounting principles.

What remained was the measure of the size of our deficits which accumulated between fiscal years 1970 and 1980 under the old cash basis of accounting.

When I presented my financial plan in July 1980, I estimated our accumulated deficit to be $409 million. But even with employee layoffs, tax increases, and other extraordinary measures by the close of 1980 it was $388 million, $19 million lower than projected.

I would like to add that Delegate Fauntroy, Chairman Arrington Dixon, and other elected officials, and I therefore propose that we enter the bond market to eliminate the past years' liabilities as we continue to assure that no future deficits will occur.

In my prepared statement I have outlined all the options that I think were available to us. We first proposed the use of the Federal

Financing Bank. However, we have had to discard this possibility because the present administration is not favorably disposed to authorize such uses of the Bank. In fact, the President is proposing to, in fact, eliminate the Federal Financing Bank as a source of financing for the projects.

The other was the Federal bailout. I believe so strongly in home rule that this process was not even suggested ever that the Federal Government, even though it is legally and logically obligated for some of the deficit, we should not ask the Federal Government for this bailout.

The other was massive expenditure reduction. We think we have done everything we think to reduce our budgets, to tighten up our management, and to curtail such basic programs as we need to operate on.

Therefore, we have done all we could to do that, but there was no way that we could reduce our spending to the point where we could save and get $388 million to take care of the deficit.

We looked at major tax increases. We rejected that in the sense that our income tax rate is 11 percent, whereas the Maryland rate is 5 percent and the Virginia rate is 5¾ percent.

Our business tax is 9.9 percent, whereas the Maryland rate is 7 percent and Virginia is 6 percent. Our sales tax is 6 percent whereas Maryland is 5 percent and Virginia is 4 percent.

So, we think that our people are already taxed enough. Therefore, that was not a viable option.

We have also looked at the pay-as-you-go arrangement. If we had a choice in this matter, Mr. Chairman, we would like the Treasury to lend us $184 million without any interest. We would pay this back in 7 years or more.

However, again, we rejected that approach.

Senator MATHIAS. If I had a choice, I would like that, too.

Mayor BARRY. I understand what we would like. People do not think we are not looking at what we like. We just present what we think is a reality base.

Therefore, we have come to the realization that the issuance of bonds is the best alternative because it achieves the basic objectives of the District.

It increases our current cash assets required to offset current demand liability and, thereby, lets the District pay its commitments on time without depending on the Treasury for cash advances.

It also eliminates the general fund deficit conditions to the extent necessary to permit immediate access to the tax-exempt municipal bond market for future financial requirements in the capital area.

The bill before you does not ask for a bailout of the District. It does not ask the Federal Government to guarantee the District's debts. It does not, in fact, place $1 of the Federal Government's money at risk.

The District of Columbia is prepared to place itself in the same position as any municipal-State government in solving our financial problems.

Consistent with these sentiments and to indicate positively that this bond authorization is not intended to impose any liabilities or

obligations on the Federal Government, we propose to add language to the bill which would make clear, beyond any doubt, that the bill does not provide for any Federal subsidy, loan guarantee, or any other type of bailout.

Our bond counsel has drafted a suitable provision and will make it available to the committee.

In addition, Mr. Chairman, underwriters of municipal bond credit analysts and others have made it clear that to issue bonds in the District must provide firm commitments that future operating budgets will be balanced.

Thus, proposed bond legislation not only would fund the deficit but would also provide additional balancing budget incentives.

We have had extensive and successful hearings before Chairman Dellums in the House Committee on the District of Columbia at which time proposed legislation was introduced and endorsed by both the U.S. Treasury Department and the Office of Management and Budget as a feasible and desirable way to resolve the city's problems of its past committed deficits.

Representatives of the two major bond rating agencies also agree that the bond concept is an acceptable solution.

We certainly would urge the committee, after extensive hearings, to support Senate bill 744. We think that before the end of the week the House District Committee will have met and marked up a similar bill and will be prepared to take it before the House fairly soon.

We would like to urge the Senate to do the same so that we can get on about the business of getting the money and paying our debts and continuing to balance our budget, and continuing to do all we can to make our government work for all the people of the District of Columbia.

Again, Mr. Chairman, thank you very much for your speedy hearings on this matter.

Senator MATHIAS. Thank you, Mayor Barry, for your statement.

Let me just ask you a few questions with regard to the whole program.

No. 1, is there essential agreement on this figure of $184 million? Is there anyone who challenges that as an accurate estimate of the cash shortfall?

Mayor BARRY. According to all the persons who are knowledgeable, Mr. Chairman, there has been agreement on the overall $388 million figure. GAO has been involved with that.

To my knowledge there has been no disagreement about the figure. Everyone agrees that the District needs cash to not only balance its accounts but to pay debts incurred prior to 1981. We are now taking 1981 revenues and have paid our prior years' bills.

Senator MATHIAS. What is the deficit above and beyond that $184 million?

Mr. ROGERS. It is $204 million, Mr. Chairman. The total accumulated deficit is $388 million. We projected that we need $184 million in cash of the $388 million.

The remaining $204 million is not an immediate cash outlay. For example, $40 million is annual leave, that is, if the Government were to close as of September 30, 1980, we would at the time owed

out $40 million of annual leave which had been accrued to employees.

We have proposed to eliminate the remaining $204 million by setting aside $10 million beginning in fiscal year 1983 and each subsequent year up to 20 years to pay that off. That comes to a total of $388 million accumulated deficit.

Senator MATHIAS. How did you arrive at the shortfall figure? That is, the cash shortfall figure as a part of the total deficit of $388 million?

Mayor BARRY. Our accounting firm, Mr. Chairman, Arthur Andersen and Lucas Tucker had outlined in very specific detail what made up that $388 million. We just backed out those things that could and would not be immediate cash needs but would be an accounting deficit.

I could supply the committee with very specific details. I do not have it before me.

For example, we looked at $116 million which was owed to vendors which means that you have already obligated the money and in some instances have paid it out of this year's cash.

So, it is just a matter of taking each item that made up the $388 million. For example, there were professional taxes, which is another item.

As you know, the courts overturned that tax. We have already paid out some $33 million of this year's revenue that should be in that $388 million. So those are the kinds of things we were able to do. We can supply the committee with very specific details on that.

Senator MATHIAS. Therefore, what you have really done is sit down with the list of bills in front of you. Where you had someone saying: "Give us cash right now," you have put it down as an urgent item as part of the operating cash deficit?

And, if something might become due perhaps next month, or next week, or next year, that is included in the $204 million?

Mayor BARRY. As Mr. Rogers said, annual leave is an example. We know that the Government is not going to close down. From an accounting point of view you should have in the bank $40 million to pay annual leave to those employees who would leave. That is one item.

With $96 million for interest, for instance, which is an accounting situation, is another item. What happened, as you know, is that we close our books on September 30, but we pay out debt service, if the appropriation has been approved by the Congress and signed by the President on October 1, that is a 1-day difference of $96 million.

Our accountants tell us that we have to carry it that way but that is not an immediate cash need because we could pay it the next day if the Federal payment is authorized. The Treasury takes its money off the top. We get the rest of it.

Senator MATHIAS. No one would send the sheriff after you for that particular item.

Will you propose to fund this in any way or just to carry it as you have described it?

Mayor BARRY. As Mr. Rogers explained, from an accounting point of view we will set aside $10 million for the next 20 years

which eventually means that we will have $200 million in the bank to cover this liability.

What you do is to take all of your assets and line them up on one side and all your liabilities on another and see what the difference is. The District has a net negative bottom line of $388 million.

Over a period of time, Mr. Chairman, not only will we have paid back the $184 million, but in 20 years, particularly if we keep all our budgets balanced for the next 20 years, we will have eliminated entirely, from an accounting point of view and a cash point of view, the entire deficit.

Senator MATHIAS. Will these problems recur in succeeding budgets or can they be corrected by accounting practices?

Mayor BARRY. We must maintain, beginning with 1981, a balanced budget. If our budgets get unbalanced, then you add to the deficit.

I am committed, as long as I am Mayor, to balance the budget every year. Whether that means a tax increase, or a reduction in spending, or a combination of the two, we will balance our budget.

As you indicated in your statement, this year we are on track. We get a monthly report and review of our current spending and also our projected spending for the rest of the year. Both budgets are balanced.

Unless Congress unbalances it, it will be balanced. As you know, over the years the District has been treated as a Federal agency. If you want to add $2 million or $3 million in budget authority, you just do it without necessarily finding the revenue to support it.

So, we think we have the Congress, and particularly Senator D'Amato and Congressman Dixon who chair the two subcommittees.

In line with that philosophy, they cannot unbalance the budget either. If they want to add money to a program they have to take it from somewhere else.

Senator MATHIAS. Will this item or group of items have any effect on the bond market so far as you can see?

Mr. ROGERS. We do not think so, Senator, because our feeling is if we can get the $184 million that will clear off the cash portion of the deficit. The remaining $204 million—most cities, counties, and States in the country do not accrue certain items such as annual leave and debt service.

Because we have Arthur Andersen, they are the only major accounting firm in the country that accrues everything. So, there is some debate in the accounting profession about whether or not a portion of the $388 million really is a deficit.

So, our feeling is that from the financial experts if we can get the $184 million and clear that off, then we can successfully compete in the bond market, particularly because we have a plan to eliminate the remaining $204 million which would be $10 million over the next 20 years.

Therefore, we feel pretty confident that the District, given the fact that we are going to balance our budget and demonstrate that in 1981 and in succeeding years and the fact that we are going to pledge a stream of revenues to retire the amount of interest on the bonds, that clearly we can get a favorable bond rating.

Senator MATHIAS. I am called away from the chair for a moment. I will ask counsel to propound to you the next question which I planned to ask you. I will be right back.

Ms. MAYER. Is it your opinion that the Home Rule Act would not allow the city to issue and sell general obligation bonds to fund the accumulated operating deficit without the amendments proposed in S. 744?

Mayor BARRY. That is the opinion we have received from corporation counsel and others who have studied the Charter.

Ms. MAYER. As the chairman noted in his opening remarks, last week you announced the city is expected to close the fiscal year with a $7 million surplus.

Could you briefly summarize your figures and how you came to the conclusion that you will be seeing a surplus this year?

Mayor BARRY. Each agency has a budget. The budget is approved by the Mayor in terms of submissions to the Council and voted up or down by the Council.

I sign the final bill when it is sent to the President. It comes to the Congress and a budget is adopted. So each agency has a budget. For instance, the Mayor's office—my budget is $971,000. It was adjusted midyear downward by $140 million as part of our contribution to rearrange and restructure the budget.

Then you just take what has been spent up to now, in terms of obligations to give you the obligations. Then you mathematically project what you are going to spend for the rest of the year.

You come to a number. In most instances, that number is below what the budget is. There are several agencies, such as the public schools and the courts which have exceeded their budget authority, so you subtract the two out and look at the revenues.

We have been fortunate that our revenue income is projected to be about $29 million over that which is estimated. You mathematically subtract that out and you come to about a $7 million figure.

If we continue to be as tight as we have been and keep our management together, we should have about $7 million in revenues in the Treasury more than we anticipated.

Ms. MAYER. We also assume that you have no reason not to expect an unqualified audit in fiscal year 1981; is that correct?

Mayor BARRY. We are working hard to make sure we do not slip backward.

Ms. MAYER. How essential is a balanced budget in fiscal 1981 and outyears to a successful entry into the bond market to fund the operating deficit?

Mayor BARRY. It is very essential. Underwriters and others have indicated to us that people have to have confidence in the city's ability to manage its financial affairs so that bondholders can get paid.

If they see that you have already accumulated the deficit in the operating budget and that you are not taking any steps to correct it, and it will get worse, they will not have much confidence in the bonds and will not buy them.

Therefore, we have to have a balanced budget in 1981 and for the next 20 years. In fact, we should have one forever.

Certainly during this period you have to have it.

Ms. MAYER. The next question, I think, is an important one for our record. What timeframe do you currently envision for marketing the bonds for S. 744?

Mayor BARRY. As I understand it, as soon as the Senate and the House act on this, we are prepared. We have financial advisers. We have bond counsels prepared to begin putting together the necessary documents to get us into the market, that is, after the City Council acts.

Once the authorization goes forward, we have to prepare a bond bill and send it to the Council. They have to have hearings on it. A timeframe would probably be 90 days after the House and Senate act.

What we could probably do, although I have not discussed this with the Treasury, is this. If we got the bond authorization act through the Congress, signed by the President, and got a bill through the City Council, we probably could defer the repayment from some of our cash advances which are now $80 million to permit us to do some others. They then could feel confident that we will pay them back.

Ms. MAYER. Therefore, it is not possible for you to issue and sell the bonds before the end of fiscal year 1981?

Mayor BARRY. It is unlikely.

Ms. MAYER. What is that going to do to your fiscal 1981 budget?

Mayor BARRY. The impact is on the cash, not on the budget. The budget will be balanced from both a budgetary point of view and an obligational point of view.

What it means is that we are going to have some serious cash problems. We have some already. We have just gone back to the Treasury for another $40 million to give us $80 million. We are committed to pay that back at the end of fiscal year. On the other hand, if our cash flow is such that we cannot pay it back, we have to negotiate it with the Treasury to carry it over into 1982. Eventually if we do not get this $184 million, the District government's treasury will be dry. We will not have any cash in it.

Senator MATHIAS. There has been a lot of public debate on the bond issue. A lot of it has centered around the philosophical question of whether or not you ought to use borrowed money to fund an operating deficit.

There have been a number of suggestions as to other things you can do. You touched on this in your statement. What are some of the alternatives?

Mayor BARRY. We have examined them, Mr. Chairman. As I understand it, our preferable alternative would be for the U.S. Treasury to lend us $184 million or to lend us $184 million at the same interest rate as you could get it on the open bond market.

We would take that one immediately, but we do not think it is a viable alternative. We do not like the idea of a Federal guarantee because in every instance where you have a Federal guarantee it means another supervisory board over the District as there was in New York over the Lockheed situation.

We do not need that. We have enough structures, as you very well know which help supervise us. We will look at all the options. The Federal Financing Bank, as I indicated, was our earlier prefer-

ence. However, again that is not a viable alternative because the bank itself does not have a lot of support.

Therefore, we think this is the better alternative out of all we have. If anyone has a better idea to get $184 million, let them come forth. We have not had anyone come forward and do that.

Mr. ROGERS. Senator, I would like to add this. All this legislation would do would be to authorize the Government—the City Council may decide after hearings. Some people have proposed that we ought to sell all the land in the city. Some people have proposed that we ought to reduce further the work force. Some people propose that we ought to increase taxes or a combination of all three.

But it seems to me that the key issue is whether or not the citizens of the District of Columbia and their elected officials ought to make the decision. This legislation simply provides the authority. Whether or not the city exercises that authority, is something the city ought to decide.

Senator MATHIAS. Therefore, the District government has not precluded the possibility of the sale of real estate or other methods of raising the cash?

Mr. ROGERS. That is correct, if, in fact, the Mayor and the members of the Council could decide to do that. Our plan, though, is this. We are looking at fiscal years 1983, 1984, and 1985. We are not only looking at one fiscal year.

Because we are landlocked we are restricted in terms of our options with the highest tax jurisdiction in the area. The Mayor has to look 2 or 3 years down the road. But some people only have to look at 1 year.

Therefore, we do not want to close off any options.

Senator MATHIAS. Of course, one possibility would be to go directly to local banks and ask them to take over the role which the short term window at the Treasury has played.

Has the city looked into that possibility?

Mayor BARRY. We think at some point—and I think the legislation takes us through fiscal year 1983—we are going to have to go to local banks for short-term borrowing anyway.

That means that we may need $40 million to take care of a valley in our cash flow as other cities have done with local banks.

Let me say this. Our local banks are not that strong that they can just lend the city millions of dollars. They do not have those kinds of assets.

If you looking at the banking industry in the District compared with New York, Chicago, California, and others—I do not have the numbers and I do not know how the largest bank rates nationally, but it certainly is not among the top 20.

So, the assets are not there to lend the city, even with all the faith and credit in the District, so much money. We will need that anyway. We will need that short-term borrowing access after fiscal year 1983 because the Treasury will not allow us to continue to borrow there.

This is a different kind of problem. We need that short term——

Senator MATHIAS. Therefore, you have other plans for the local banks?

Mayor BARRY. That is right. Someone said that local banks ought to lend us all that $184 million. They do not have the capacity to

lend $184 million out for 30 years. Banks do not lend money like that. They usually make short term loans.

Senator MATHIAS. One of the things which I know you have in mind in retiring the accumulated deficit is to prepare the way for your entry into the bond market. Is that not correct?

Mayor BARRY. That is correct.

Senator MATHIAS. You are trying to set your house in order so that when you go to the bond market they do not point to a lot of red ink. Is that right?

Mayor BARRY. Let me just say this, Mr. Chairman. My administration has taken a comprehensive approach to this problem, not a piecemeal 1-day solution or a 1-month solution.

We looked at the whole problem we have and the solutions comprehensively. That means that all the pieces fit together in an interlocking way for the next 4, 5, or 8, years.

Senator MATHIAS. That is what I want to do right now, to look at it comprehensively with you and to project the effect of the passage of this bill.

Let us say that subsequent approval by the City Council of the issuance of bonds under Senate bill 744 is given. What will that do to a further bond issue, let us say, for capital improvements?

Mayor BARRY. We think it will substantially improve our ability to enter the bond market for capital products, Mr. Chairman. Our financial advisers believe this. I am sure you will hear testimony before the committee which will substantiate that.

It further strengthens the District's stability from the financial and accounting point of view so that the bonds that we then market for capital projects will give us a better rating—we will get a better rating and in turn get a better interest rate on the tax-exempt bonds.

It will substantially strengthen the District's ability to enter the bond market for capital projects.

Mr. ROGERS. It is in the District's best interests to go to the bond market. We are currently paying for perhaps as high as 20 percent more to borrow from the U.S. Treasury.

The taxpayers of the District are losing money. Therefore, it is in our best interest to go to the bond market in the first place.

So, we have to clean up our books and get our house in order. In the long term, then, we can save money.

Senator MATHIAS. You say that it is in your best interest to go to the bond market for this purpose and you think it will actually enhance your position with the bond market.

Mayor BARRY. Let me just add to that, Mr. Chairman. This approach for the operating deficit of $184 million is not our preference. This is the only reality base proposal we can find.

Senator MATHIAS. I understand that.

Mayor BARRY. I just want to say again this is not our preference.

Mr. ROGERS. Normally you would not do it this way, we concur.

Senator MATHIAS. I understand. I just want to probe what the effects of it would be.

Mayor BARRY. The effect of it would be to strengthen the District's ability to go to the bond market for capital projects.

Senator MATHIAS. Turn that coin over. Suppose Congress denies you the authority under S. 744. What will that do to your position on the bond market?

Mayor BARRY. According to our financial advisers it will make it very difficult to go to the bond market for capital projects.

Mr. ROGERS. Let me tell you what would happen. We simply would continue to operate the way we have operated for the last 200 years, that is, to live from day to day, delaying payments, having severe cash flow situations, going to the Treasury to borrow money. The Treasury would then have to rescind its position because clearly if you deny us, we are going to have to capital borrow from the Treasury someplace. That is a reality.

So, we would just be where we have always been.

Senator MATHIAS. That is what I have told them.

Mr. ROGERS. That is exactly where we would be. That is no way to run a government. It is our position that the District should not be the only entity in this country which operates this way. It is a disincentive for good management.

Senator MATHIAS. The only advantage to it is that you have the only banker in the world which does not bounce your checks.

Mr. ROGERS. Which one is that? We are in the local banks. We are not in the Treasury anymore.

Senator MATHIAS. You said you would revert to that system.

Mr. ROGERS. In terms of doing capital projects, but in terms of operating capital—that is why we are in the situation we are in now. We are in local banks. If we were still in the U.S. Treasury, we would not have any problems. We would be part of that big pie that everyone is taking from.

Senator MATHIAS. You agree with me that it is pretty nice to have a banker that does not bounce your checks even when they are rubber?

Mayor BARRY. Sir, let me just say this. The thing that keeps the city administrator's on their toes is that the bond market itself requires certain stringent things to happen. If you want to be successful in getting your buildings built or swimming pools, or schools, that means you have to be successful in balancing your books and your budget.

I like that challenge and I think the citizens of the District of Columbia like that challenge. If we had been in the U.S. Treasury, as we were prior to 1978, we probably would not be sitting here in the sense that we would have let the checks keep being written and we would have been responsible, I think, but no one would have known about it. We would have kept writing checks and kept overspending. Then somebody would have discovered this in another 10 years from now.

But we do not like that approach. We want to be responsible. We want to do like everyone else does in the sense of carrying our weight. I want to do what Mayor Schaeffer has to do and the other great mayors in this country have to do in the sense of being financially and fiscally responsible.

I take on that challenge gladly.

Senator MATHIAS. What you are really saying is that this is not something which you embrace enthusiastically; but that you do it because you do not see any alternative?

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Mayor BARRY. Yes, sir; absolutely.

Senator MATHIAS. And you believe it will not adversely affect other bond issues for capital purposes which you may have to try to float later?

Mayor BARRY. It will not only affect it negatively; it will affect us positively. Our advisors who advise us every day say that it will allow us to have a stronger position for our capital projects.

Senator MATHIAS. Mayor Barry, of course you realize you are taking on a whole new series of public efforts and sacrifices in getting into the bond market?

Mayor BARRY. Yes, sir.

Senator MATHIAS. You have to go up to New York. You have to spend a day or two in New York in the flesh pots of Wall Street signing your name again, again, and again on the bonds, going out to lunch with those bankers. [Laughter.]

There is just one more sacrifice that you will have to make in the course of your duties.

Mayor BARRY. I agree. I look forward to going to New York and taking a day off. We realize that we will add to what we have to do, but again—Mr. Chairman, I believe as you probably believe that when you want freedom and independence you have to sacrifice for it. This country is rich in that heritage of struggling for freedom and independence and making sacrifices.

Some people have even given their lives for that basic tenant. We say that we want home rule; we want self-government. We have to make the sacrifices and pay the price.

I think the great majority of the citizens will support me in that effort.

Senator MATHIAS. Let me just ask you a couple of further questions. Do you have any indication of how the bonds will sell or what kind of market they will have? Or, is it too early to make that judgment?

Mayor BARRY. Underwriters and other experts have stated that if we pledge a specific revenue and also if the District of Columbia is not affected by chapter IX of the Bankruptcy Act, that we can get an investment grade rating.

Senator MATHIAS. It has been suggested this morning that there is no commitment on the part of the District to issue the deficit financing bonds and that there is still the possibility of the sale of assets or some other alternative.

Do you have any idea how much of the $184 million, assuming that is what is authorized, you would issue, or would you issue some specific amount and then go to alternatives for the balance? Do you have any thoughts along that line at the present time?

Mayor BARRY. We would be guided, Mr. Chairman, by the advice of our financial advisers as to what the market looks like. We would be guided by how much——

Senator MATHIAS. How much the market would absorb at any given time?

Mayor BARRY. We would be guided by the 1983 budget and how much of a gap would be there. It is about $116 million difference of what revenues are expected in 1983 and what we have to spend. The 1984 budget would be looked at.

We are trying to put together a 5-year budget projection so we can see what these gaps are. It will also depend on the attitude of the majority of the city council as to what program they want to support.

It is a combination of options that are there.

Senator MATHIAS. Municipal bonds frequently pledge a specific municipal revenue as part of the security for the bonds.

Have you given any thought as to which particular source of revenue you would identify in this connection?

Mayor BARRY. We will probably go to one of the three big ones. Our income taxes are a big revenue strain with $300 million; the property tax is over $200 million; and our sales tax is over $150 million.

Any combination of those or one of those would satisfy, from the advice we have gotten, the bond buyers. We think it would be anywhere between $17 million and $20 million in repayments. Any source of revenue which has that space in it would satisfy the bond holders.

Senator MATHIAS. What about the referendum provision of the Home Rule Act? Would the bond issue be subject to that?

You referred to my friend, Mayor Schaefer. He suffers through these referendum issues every election.

Mayor BARRY. Mr. Chairman, let me get back to the committee on that. There was some question or debate. My memory is not fresh on it as to whether or not this particular bond issue would be subject to our referendum or whether future ones would be.

[The information referred to follows:]

THE DISTRICT OF COLUMBIA,
Washington, D.C., January 11, 1982.

Hon. CHARLES MCC. MATHIAS, Jr.
Chairman, Subcommittee on Governmental Efficiency and the District of Columbia, Committee on Governmental Affairs, U.S. Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your question as to whether the bond issue, authorized by S. 744, the Bond Authorization Act, would be subject to the referendum provisions of the Home Rule Act.

The District's Bond Counsel, Mr. Roswell C. Dikeman, was asked to provide an opinion on this question. By letter dated December 8, 1981 Mr. Dikeman advised that "pursuant to paragraph (6) of section 462 of the Home Rule Act, the Council may determine, in its discretion, to submit the question of issuing any bonds authorized pursuant to the bill to a vote of the qualified voters of the district; and the referendum process provided in Charter Amendment Number I would not apply to any act of the Council authorizing bonds pursuant to the bill.

I have enclosed a copy of the letter from Mr. Dikeman for your information.

I trust this information proves beneficial for your purposes.

Sincerely,

MARION S. BARRY, Jr., *Mayor.*

Enclosure.

WILLKIE FARR & GALLAGHER,
New York, N.Y., December 8, 1981.

BARBARA C. WASHINGTON, Esq.
Assistant City Administrator for Intergovernmental Relations, Washington, D.C.

DEAR MS. WASHINGTON: This is in response to your letter of December 2, 1981, in which you request our opinion as to the applicability of the "referendum provisions" of the Home Rule Act to bond authorization acts adopted by the District Council pursuant to the District of Columbia Bond Authorization Act of 1981 (S. 744).

You indicate that during the hearing on this bill, Senator Mathias posed the following question to Mayor Barry: "What about the referendum provision of Home

Rule? Would the bond issue be subject to that?" You state that our opinion is needed to respond to this question.

Under the provisions of S. 744, the District would be empowered to issue its general obligation bonds in a limited amount for the purpose of paying "eligible liabilities" and certain other items as specified in Section 3. Section 4 of the bill provides that the Council may authorize the bonds in question by one or more acts "adopted in the manner provided in the Home Rule Act". Subsection (a) of Section 4 provides that any such act shall take effect immediately and the provisions of Section 602(c) of the Home Rule Act shall not apply thereto. Subsection (d) of Section 4 of the bill provides that the provisions of Charter Amendment Number 1 "shall not apply to the authorization, issuance or payment of the bonds."

The following are our conclusions with respect to the question posed by Senator Mathias:

(1) Pursuant to paragraph (6) of section 462 of the Home Rule Act, the Council may determine, in its discretion, to submit the question of issuing any bonds authorized pursuant to the bill to a vote of the qualified voters of the District; and

(2) The referendum process provided in Charter Amendment Number 1 would not apply to any act of the Council authorizing bonds pursuant to the bill.

If we may be of further assistance, please advise.

With best wishes,

Sincerely yours,

R. C. DIKEMAN.

Senator MATHIAS. Let me leave that question with you and let me also take this oppportunity to submit to you several other technical questions and ask you to answer them and return them for the record as soon as possible.

Senator Eagleton also has some questions, but he is delayed at another committee meeting.

So, I will propound the balance of my questions and Senator Eagleton's questions to you in writing and ask that you let us have the answers by the end of the week.

Without objection, so ordered.

Unless you have anything further then, Mayor——

Mayor BARRY. Let me say in closing, Mr. Chairman, that this is our best shot at solving this problem. If there are other alternatives which are viable which can get us $184 million in the next 3 to 6 months, we will take that.

In the absence of any other viable alternatives, we will certainly urge the committee, after careful consideration, to pass Senate bill 744.

Senator MATHIAS. Thank you very much, Mayor.

Mayor BARRY. Thank you, Mr. Chairman.

[Mayor Barry's prepared statement and responses to written questions submitted by Senators Mathias and Eagleton follow:]

PREPARED STATEMENT OF MAYOR BARRY

First, let me express my appreciation to you, Mr. Chairman, for scheduling hearings on S. 744 so quickly. These hearings set the stage for the mutually responsible actions which will follow.

All across America, we find cities with severe financial problems: Boston, Detroit, New York, Newark, Cleveland, Chicago, Buffalo, and now Washington, to name a few. As the chairman and Senators well know, our nation's cities must cope with the overwhelming burdens of deficient tax bases, joblessness, high crime rates, drugs, inadequate housing, public assistance, and a vast array of other social and economic problems.

We must all keep in mind that D.C. in particular faces extraordinary pressures, because:

We have no State government to turn to for help. The average large city in America has over 20 percent of its budget funded by its State.

Two thirds of the District's land is tax exempt.

Two thirds of the income earned in the District is tax exempt.

The Federal payment is designed to compensate us for tax exemptions granted by or to the Federal government. However, the Federal payment, now set at $30 million per year, falls far short of the $641 million value of Federal tax exemptions; and finally the D.C. Government accumulated a large deficit prior to home rule in 1975, and since home rule until fiscal year 1981.

Let me expand on that last point. Under the Federal government's guidance the District was on a cash basis of accounting. This meant that we could defer large and steadily increasing sums of accounts payable into future years—and still technically have a "balanced budget."

Quite frankly, Mr. Chairman, we could have continued such financial practices and added to this accumulated deficit. We could have postponed the day of reckoning to some future year.

In concert with the financial oversight commission, I chose instead to confront directly the District's inadequate budget practices. The fiscal year 1981 budget amendment was my first opportunity to shape a different kind of budget, a budget that was fully balanced under generally accepted accounting principles.

What remained was to measure the size of our deficit which accumulated between the fiscal years 1970 through 1980 under the old cash basis of accounting. When I presented my financial plan in July of 1980, I estimated our accumulated deficit to be $409 million through fiscal year 1980. Even with employee layoffs, tax increases and other extraordinary measures, by the close of fiscal year 1980, the accumulated deficit was $388 million—$19 million lower than projected.

Of the total $388 million in accumulated deficit through 1980, we have estimated—with the best financial advisors available—that our immediate cash needs are $184 million.

Delegate Walter E. Fauntroy, Chairman Arrington L. Dixon, other elected officials and I are therefore proposing that we enter the bond market to eliminate the past year liabilities, as we continue to assure that no future deficits will occur. This course of action is essential to assure that we are a financially sound government, responsible for solving our own problems.

We reached the decision to enter the bond market after considering a wide variety of other options, which I will now discuss with you:

OPTION 1—USE OF FEDERAL FINANCING BANK

The use of the Federal Financing Bank was initially put forth as a potential solution. However, we had to discard this possibility because the Reagan administration is not favorably disposed to authorize such uses for the Bank.

OPTION 2—FEDERAL "BAILOUT"

I will not forego my commitment and the mandate of our citizens—and indeed, the commitment of this body—to home rule. I therefore cannot ask for a Federal bailout.

OPTION 3—MASSIVE EXPENDITURE REDUCTION

If the District had an expenditure budget that contained much discretionary spending beyond basic municipal services, we could drastically cut expenditures—but we have already severely curtailed even basic programs to minimize the fiscal year 1980 deficit. We have made even further reductions to maintain balanced budgets in fiscal year 1981 and 1982. This is made even more difficult because of the added impact of the Federal government's own budget balancing actions. Indeed, trying to take $184 million from our current budget would totally cripple city services.

OPTION 4—MAJOR TAX INCREASES

Another option we rejected was to increase taxes. As you know our citizens are the highest taxed in the region and among the highest taxed in the Nation. For example:

Our income tax rate is topped at 11 percent, whereas the Maryland rate is 5 percent, and Virginia's rate is 5¾ percent.

Our business tax rate is 9.9 percent, whereas the Maryland rate is 7 percent and Virginia's rate is 6 percent.

Our sales tax is 6 percent, whereas the Maryland rate is 5 percent and Virginia rate is 4 percent.

These are only a few examples of the heavy tax burdens carried by our citizens due to taxing restrictions placed on us by Congress. To raise $184 million from tax revenues, we would have to impose a 30-percent surtax on our income and business franchise taxes along with a doubling of our personal property taxes. We concluded that this type of proposed solution would accelerate the loss of population and businesses and is therefore unacceptable.

OPTION 5—PAY AS YOU GO

We have had suggested to us a pay-as-you-go plan. Under this plan, we would receive Treasury advances for all of our immediate cash needs, and set up a fund of $20 million per year. The $184 million deficit would be eliminated by the end of the seventh year. The Treasury has rejected any proposal to use interest free cash advances over an extended time period.

The option of issuing bonds was selected as the best alternative because it achieves the two basic objectives of the District:

1. It increases current cash assets required to offset current demand liability, and thereby lets the District pay its commitments on time, without depending on Treasury for cash advances, and

2. It eliminates the general fund deficit condition to the extent necessary to permit immediate access to the tax exempt municipal bond market for future financing requirements.

The bill which you have before you does not ask for a bailout of the District. It does not ask the Federal Government to guarantee the District's debts. It does not, in fact, place one dollar of the Federal Government's money at risk. The District of Columbia is prepared to place itself in the same position, as any municipal or State government, in solving our financial problems. Consistent with this sentiment, and to indicate positively that this bond authorization legislation is not intended to impose any liabilities or obligations on the Federal Government, we propose to add language to the bill which would make clear, beyond any doubt, that the bill does not provide for any Federal subsidy, loan guarantees or other type of bailout. Our bond counsel has drafted a suitable provision to this effect, and will make it available to the committee.

In addition, underwriters, municipal bond credit analysts, and others, have made it clear that to issue bonds, the District must provide firm commitments that future operating budgets will be balanced. Thus the proposed bond legislation will not only fund the deficits, but also provide additional budget balancing incentives.

This legislation would authorize the District of Columbia government to issue general obligation bonds, without any direct Federal assistance or guarantees. The proceeds of these bonds will be used to finance the critical $184 million portion of the September 30, 1980, accumulated general fund deficit of $388 million. The repayment of the proposed bond issue will be from the city's own resources.

Extensive and successful hearings were held before Chairman Dellums and the House Committee on the District of Columbia, at which time the proposed legislation was endorsed by both the U.S. Treasury Department and the Office of Management and Budget as a feasible and desirable way to resolve the city's problem of its past accumulated deficit. Representatives of the two major municipal bond rating agencies also agreed that the bond concept is an acceptable solution.

Mr. Chairman and members of the committee, I would like to say that delegate Walter E. Fauntroy, Chairman Arrington Dixon, And other D.C. officials, top financial advisors and I have evaluated our entire financial solution thoroughly, and arrived at the conclusion that S. 744 should be fully supported. I am confident that after you explore all the options, you will join with us in our decision, which places our local government on the soundest possible financial basis.

RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR MATHIAS

Question 1. Do you have any idea of what revenue source or sources you intend to pledge as security for the bonds issued and sold pursuant to S. 744?

Answer. It is anticipated that the revenue pledge would involve one of the District's major revenue sources: individual income tax; general sales tax; or real property tax. The choice of the specific source will.

Question 2. Do you anticipate use of the Federal payment as the revenue source to be pledged?

Answer. The Federal payment, unlike the other sources above, must be annually appropriated by Congress before it is received by the District. Because prospective underwriters might consider this an undesirable characteristic of the Federal pay-

ment, it is not expected to be pledged at this time. However, the District should have the flexibility to negotiate the best terms for the bonds, including the option of pledging this District revenue source.

Question 3. Can you anticipate at this point how long the bonds will be issued for. In other words, would you expect to issue the the bonds for the full 30 years authorized?

Answer. Although it is anticipated that the term of the bonds will not exceed 20 years, the exact maturity schedule should be designed to take maximum advantage of municipal market conditions prevailing at the time of sale and, thus, would be determined at a point closer to then.

Question 4. S. 744 specifically exempts the proposed bond issue from several provisions of the Home Rule Act. I would appreciate your commenting on these sections. Specifically:

The bill would exempt the proceeds from the bond sale, the amounts obligated for the payment of bonds and the pledge of revenue to secure the bonds from the Congressional appropriations process. Why is this necessary?

Answer. Without the exemption from the Congressional appropriations process, a District bondholder could not be assured of the legal availability of his principal and interest payments when due, or of the legal availability of pledged revenues if and when he might otherwise have a valid claim thereon by virtue of the security provisions of the bonds. Although it seems unlikely, absent an exemption, that Congress would not make an appropriation would not be made in time to meet a payment due date would have a substantial negative impact on the creditworthiness and marketability of the bonds.

The proceeds will be used to liquidate prior-year liabilities contributing to the accumulated deficit. These liabilities arose when operating expenditures were made pursuant to appropriations, but in the absence of sufficient revenue to finance the appropriations. The proceeds of the bonds, therefore, merely finance previously appropriated expenditures and an appropriation of proceeds would be improper, since no new or additional expenditures would be made from them.

Question. The bill would exempt the principal and interest payments due on the bonds from the debts limits contained in the Home Rule Act. Why is this necessary? Is it wise, as far as municipal financing is concerned?

Answer. The 14 percent statutory debt service limitation is designed to control debt service obligations resulting from the financing of the District's ongoing capital program, whether by bonds or by Treasury loans. It is, in fact, a "conservative provision of the Home Rule Act," according to testimony on H.R. 1807 by Mr. Hyman C. Grossman of Standard & Poors's Corporation.

The issuance of bonds pursuant to S. 744, on the other hand, will be a one-time occurrence designed essentially to manageably finance previously unfunded accummulated operating expenditures over a number of years in the form of annual debt service payments. The limited impact of this remedial action should not be allowed to further restrict the District's ability to maintain and finance its continuing capital program by the inclusion of debt service on these bonds within the 14 percent capital debt service limit, thereby crowding out some statutorily permitted capital funding capacity.

Question. The bill would exempt the bond legislation which the City Council is authorized to enact pursuant to S. 744 from the Congressional layover period—an integral part of the Home Rule Act. Why is this proposed?

Answer. Action to correct an accumulated deficit condition should be undertaken expeditiously. Over a year has elapsed since this problem was identified and the basic solutions proposed. The Distict continues to suffer consequences of the unresolved accumulated deficit problem, chronic cash flow stringency and inability to realize interest cost savings through issuance of capital bonds, among the major of these.

Capital bonds, as contemplated by the Home Rule Act, will not be scrutinized by Congress before the adoption of the Council's bond act authorizing their issuance, but will be subject to a layover period. In this case, however, as evidenced by these and recent House hearings, Congress is thoroughly examining the fundamental nontansactional features of the proposed bonds and Congress must affirmatively authorize them before the Council acts. Bonds issued pursuant to this one-time authorization will be sold within months of this Congressional scrutiny and approval. Subjecting the bond act to layover in this instance would be highly redundant, as well as detrimental to the expedient correction of the accumulated deficit problem.

Question 5. As the Treasury Department witness testified, a problem may arise because of the prior lien that the Federal government has on District assets as a result of the $1.5 billion in outstanding capital improvements loans to the City.

Answer. The Treasury Department in its testimony indicated a "minor concern" about the relationship of the security for the proposed District double-barrelled bonds and the security for outstanding Treasury capital loans. The Treasury loans are secured primarily by the full faith and credit of the District Government, which means that the District promises to raise taxes if necessary to pay the debt service when due. The proposed bonds will be secured by a full faith and credit pledge and a first lien on a District revenue. This additional pledge is necessary to separate the repayment of the publicly issued bonds from any transient financial problems which might impair the value of the full faith and credit pledge. Municipal bond issuers around the country are experimenting with similar techniques to provide additional security for their bonds in order to gain market access or to obtain lower interest rates.

The Federal government does not have a prior lien on District assets. The Distict does not seek to reduce the security the Federal government does have, which is primarily a general obligation full faith and credit pledge. In fact, the proposed legislation merely puts the new bond holders in an equivalent position to that of the Treasury when one takes into account the full range of security possessed by the Treasury.

In practice the debt service owed by the District to the Treasury is paid from the Federal payment when it becomes available. Because it holds the Federal payment the Treasury is, in effect, additionally secured by its ability, if required, to set-off the debt service owed to it from the Federal payment owed the District. The Treasury can therefore be said to have a prior position with regard to the Federal payment. The proposed legislation would simply permit the District to offer purchasers of its bonds a prior position with regard to a locally generated revenue. The unique situation of Treasury loans and Treasury administration of a large Federal payment makes this situation quite different from the ordinary cases whether Treasury has been concerned about subordination of its interests.

Question. Are you able to assess the effect that the Federal government's prior lien on District assets will have on the marketability of the proposed bonds?

Answer. The Federal Government does not have a prior lien on District assets, as noted. Notwithstanding this fact, if the District were required to extend the pledge of its locally generated revenue to include the Treasury it would significantly diminish the affectiveness of the bonds in the public credit markets. Such a requirement would have three major effects:

(1) it would diminish the amount of revenue securing each bond preventing the Distict from promising significant coverage to bondholders;

(2) it would unfairly favor the Treasury debt giving Treasury a pledge of a local revenue to add to its ability to set-off against the Federal payment and the full faith and credit pledge; and

(3) it might impair the ability of District utilities and enterprises to issue revenue bonds since such bonds require all revenue of the utility be pledged only to support the operations and debt of the utility, not the general debt of the city.

Question. How would the marketability of the bonds be affected if a specific revenue source could not be pledged as security because of a conflict with the federal government's prior lien?

Answer. If no pledge of a revenue source were possible, it is doubtful that the bonds could be issued for some period of time. The bonds would then be secured only by a general obligation pledge which at this time is not as strong as the double-barrelled bond. This weaker security would have a negative effect on the rating and marketability of the bonds. Even when marketable, the lack of a pledged revenue would mean that the District would have to pay higher interest rates on its bonds.

Question 6. The administration has recommended that interest charges be added to the District's short-term borrowing authority, that a surcharge be added to both the short- and long-term borrowing authority, and that these borrowing authorities be eliminated in the near future.

If any of these recommendations become law, what effect would they have on your budget for fiscal year 1982 and beyond?

Answer. Relative to comparable municipal bonds, the District has always incurred a substantial penalty interest cost on its taxable-rate Treasury capital loans. This penalty effect is only slightly mitigated by the absence of interest charges on repayable advances. Additional charges would be both burdensome and, with regard to the proposed surcharges, punitive since the proposed surcharges would be far in excess of any transactional or other costs to the Treasury.

Question. Would you find yourselves in jeopardy of running in the red?

Answer. If the District were unable to ameliorate the accumulated deficit by issuing these bonds in the near future, it would be forced to rely on these sources of funds from the Treasury in fiscal year 1982. The additional interest charges and surcharges are not provided for in the District's budget and would clearly jeopardize balanced financial operations.

Question. How would your ability to enter the bond market be affected?

Answer. The imposition of these additional charges and surcharges in itself would negatively affect the District's ability to enter the bond market by its unbalancing influence on financial operations. However, the District's ability to finance the crucial portion of the accumulated deficit with bonds issued pursuant to S. 744 is the fundamental factor that will generally determine future access to the bond market for capital purposes.

Question 7. In contrast to past borrowing from Treasury, I would suspect that borrowing for capital projects on the bond market can require that some difficult choices be made regarding which projects might get funded in what can often be an uncertain investment atmosphere. Nonetheless, there are certain capital expenditures which are essential to a city's well-being, such as the sewer system, major roadways, and of course in this City, numerous bridges. Could you give me some idea of what the City sees as priorities or potential problems in these key areas of assuring the viability of its infrastructure?

Answer. A committee composed of representatives of key District agencies concerned with capital improvements is now meeting with the Planning and Budget Offices to develop the capital budget for fiscal 1983, and a capital improvement plan for the succeeding five years. While much of the District's capital spending will be needed to complete projects already committed, there will be new projects proposed. These new projects will generally follow the proposed priorities listed on Attachment No. 1. Projects necessary to keep the District's physical plant and facilities functioning are the second priority, after projects required to meet statutory requirements or court orders.

RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR EAGLETON

Question 1. What percentage of the total city budget will be consumed by debt service during the next 5 years?

Answer. Because the District's capital programming process is presently being revised and future capital cash flow requirements are being reassessed, a more useful perspective for examining this question at this juncture would be to assess statutory debt service capacity including the estimated effect of the bonds authorized by S. 744. This analysis, set forth in Attachment No. 2, indicates that, over the next 4 years, there should be sufficient debt service capacity to finance the anticipated level of capital activity and still hold annual debt service below 14 percent.

Question 2. Why should the $184 million offering be excluded, as it is in S. 744, from the 14 percent debt service ceiling legislated in the Home Rule Act?

Answer. The 14 percent statutory debt service limitation is designed to control debt service obligations resulting from the financing of the District's ongoing capital program, whether by bonds or by Treasury loans. It is, in fact, a "conservative provision of the Home Rule Act," according to testimony on H.R. 1807 by Mr. Hyman C. Grossman of Standard & Poor's Corporation.

The issuance of bonds pursuant to S. 744, on the other hand, will be a one-time occurrence designed essentially to manageably finance previously unfunded accumulated operating expenditures over a number of years in the form of annual debt service payments. The limited impact of this remedial action should not be allowed to further restrict the District's ability to maintain and finance its continuing capital program by the inclusion of debt service on these bonds within the 14 percent capital debt service limit, thereby crowding out some statutorily permitted capital funding capacity.

Question 3. How much debt service do your experts estimate the City can carry now and into the future?

Answer. District staff and its consultants believe that, excluding the requirements for these bonds, a relative level of 14 percent of revenue, as provided for in the Home Rule Act, is reasonable.

Question 4. What alternatives does the City propose if the City fails to obtain an investment grade rating and if the interest rates continue to climb?

Answer. The provisions of S. 744 for structuring a bond issue have been designed to permit the District to achieve an investment grade rating, which is still anticipated. Nonetheless, if this is not achieved, the sale of these bonds would be delayed. It

would then be necessary to continue to rely on Treasury advances to offset the chronic cash stringency symptoms of the accumulated deficit until a sufficiently strong bond could be structured.

Despite some near-term fluctuation, the long-term trend in interest rate levels in this century has been increasing. If interest rates at the contemplated time of sale can be determined to be temporarily high, the sale would, of course, be delayed. But if interest levels were high only as a result of the long-term trend, deferring the sale of bonds would only prove more costly and short-sighted.

Question. At this time, does the City expect its offering to be negotiated or offered for public bid? Which would be more advantageous?

Answer. A negotiated sale would almost certainly be more advantageous to the District. The complexity and uniqueness of the District's inter-governmental relationships, the absence of a market history, the complicated financial condition and the limited history of audited financial information, among other factors, would tend to significantly undermine a good competitive bid result. The District, therefore, would opt for a negotiated sale.

Question. Who will purchase these bonds? Aren't local banks the main source for such bond offerings, and is the District's financial community large enough to absorb this offering?

Answer. There should clearly be a national market for these bonds. Since there are no District bonds outstanding, a desire for portfolio diversity should strengthen national demand for District bonds relative to competing issues of comparable rating. Efforts by the District and underwriters to promote the bonds in major regional financial centers across the country will also enhance demand. The financial community in the District and this region should absorb a significant portion of the bonds; however, even if the capacity and demand existed in the city to purchase the whole issue, it would be in the District's interest to establish itself with the national market.

Many States and municipalities are now seeking entry into the bond markets. Some, like the District, hope to finance deficits. Most will seek capital funds.

Question 1. What will this competition mean to the District's entry with the $184 million offering? What will it mean when the District enters the bond market for capital projects beginning in fiscal year 1984?

Answer. The overall demand for long-term credit by states and municipalities has not changed substantially over the past three years. In 1977 $45 billion was raised; in succeeding years it was $46.2 billion in 1978, $42.3 billion in 1979, $47.1 billion in 1980, and slightly lower than the 1980 rate thus far in 1981. Less than 40 percent of this borrowing was general obligation debt with the remainder being revenue bonds.

The major impediment to marketing the District bonds in public credit markets will be the reduction in the number of buyers in the market and general economic conditions which keep general interest rates high. The traditional large purchases of municipal bonds, commercial banks and casualty insurance companies, have substantially reduced their participation in the market. These buyers have a reduced need for tax-exempt bonds due to other tax-favored investments and reduced profitability. Reductions in income tax rates will tend to reduce demand from individual investors. Also, tax-exempt rates rise and fall with general interest rates and the cost of bond issued will therefore be affected, general economic conditions. These two factors, taken together, indicate that all municipal issuers will face tougher markets in the future.

These difficult market conditions will make issuing the proposed District bonds more difficult than, for example, a year ago. Once the District has become an accustomed and seasoned issuer it should have no more difficulty than any other comparably rated issuer in marketing its bonds.

Treasury has asked Congress to phase-out the City's borrowing from that source.

Question. Will you please comment for the record on the impact to the City of the following: (1) Closure of short-term window at the end of fiscal year 1982? (2) Interest charges at the short-term window beginning in fiscal year 1982? (3) A surcharge of all capital borrowing beginning in fiscal year 1982? (4) A closure of the capital borrowing at the end of fiscal year 1983?

Answer. There will be no impact if the District can resolve the $184 million portion of the accumulated deficit and issue its capital program bonds on a timely basis in fiscal year 1982 and, thus, avoid using either of these Treasury financing sources. As a practical matter, since some lead time will be necessary to accomplish such alternative financing, this means that both S. 744 and recently transmitted technical amendments to the District's bonding authority would have to be enacted as soon as possible. In fact, the District is anxious to cease its reliance on Treasury financing, both as a matter of financial Home Rule and economics. However, since

the enabling legislation necessary to permit the use of alternative means of financing is beyond its control, the District cannot support changes which will make such Treasury financing even more restrictive and costly until there is a viable choice.

If the District is not permitted to expeditiously implement its independent financing program for fiscal year 1982, because S. 744 or the technical bonding amendments are not enacted in a timely fashion, it will be forced to rely on these sources of funds from the Treasury in fiscal year 1982. Relative to comparable municipal bonds, the District has always incurred a substantial penalty interest cost on its taxable-rate Treasury capital loans. This penalty effect is only slightly mitigated by the absence of interest charges on repayable advances. Additional charges would be both burdensome and, with regard to the surcharges, punitive since the proposed surcharges would be far in excess of any transactional or other costs to the Treasury. Such additional interest charges and surcharges are not provided for in the District's budget and would clearly jeopardize balanced financial operations.

There has been severe criticism lately of the City's sale of RLA land for development. Critics indicate that the City could be obtaining between $100 to $400 more a square foot for City property. The extra money certainly could help erase the deficit.

Question. Why isn't the City placing these lands up for auction?

Answer. The land prices for the sale of RLA sites are based on two independent appraisals, that take into consideration comparable real estate sales and the restrictions imposed on development by the urban renewal plan. These appraisals are reviewed by the DHCD staff and the proposed land price is reviewed and approved by the RLA Board. The Board's action is taken after a public hearing on the sale of a site to a redeveloper.

An auction to sell land to the highest bidder would not meet the stated public objections for development of urban renewal sites as price is a trade-off for carrying out agreed upon public objections. For example, on a residential site a bidding process with no other restraints imposed would result in housing at rents for high income families and would not provide housing to meet the needs of low and moderate income families. Similarly on a commercial site, an auction would most likely result in a single purpose use as an office building, rather than a mixed office, shopping and hotel development as proposed in the major RLA sites at Metro Center (12th and G Streets) and Gallery Place (7th and G Streets). Under the circumstances that the plan restrictions are imposed on development, the valuation factors (comparable real estate sales, renewal plan controls and public objections) would be similar in arriving at a fair market value for a site either through the current land pricing process or through an auction process.

To carry out an auction of the RLA sites would also require pre-qualification of bidders to assure that acceptable community participation and affirmative action programs would be provided. This would be time-consuming as it would necessitate a public offering and review by the RLA Board to determine the acceptability of the initial list of prospective developers.

Disposition proceeds from the sale of RLA sites either as currently carried out or through a bidding process would not provide money to help reduce the City's deficit. Any money from the sale of RLA land is to be used to repay the outstanding indebtedness on the RLA sites with any additional funds to then be used to support the community development program.

Question 2. Who conducts the appraisal? Why did the recent sale to Capital Landmark Associates bring in only $144 a square foot when the City's own statistics indicate an average downtown sale price recently of $282 per square foot?

Answer. Appraisals to recommend land values to the RLA are conducted by two independent appraisers. For Parcel 6 at 7th and G Streets, according to DHCD staff analysis, comparable nearby sales shown in the appraisal report range from $67 per square foot to $197 per square foot. Parcel 6 sold for $144 per square foot. A review of recent appraisals in the vicinity of Metro Center at 12th and G Streets showed that sales ranged from $120 per square foot to $500 per square foot, with the high price far out of line from the other comparables. For Metro Center, these comparable sales are higher than at 7th and G Streets because of proximity to sites undergoing increased real estate activity, the location at the Metro Center subway station and the central downtown location of the site.

Question 3. The argument is made that amenities that are costly must be provided by RLA developers, yet these very amenities—housing, parking, shops—seem standard in downtown developments today. Why aren't the amenities required and the land auctioned with the stipulation? If the price is low at least the fair market value cannot be challenged.

Answer. The requirements contained in the urban renewal plans are not matters of developer choice but represent specific restrictions that are imposed on proposed

development through adoption of the plan by the City Council and which must be carried out by developers. In addition a developer of an RLA site would have to have approved community participation and affirmative action programs, as well as meeting the more formal and time-consuming review process, all of which exceeds the requirements that a developer would normally have to meet on a private development site.

Although many of the amenities (arcades, retail uses along the street, provision for small businesses, and parking and loading limitations) may well be provided by developers of non-RLA sites, they are under no positive obligation to do so and are free to determine whether it is in their economic interest to provide such amenities. Because of the plan restrictions adjustment to land values are made to reflect these requirements, as well as other public objectives such as, the provision of an opportunity for displaced merchants to return, and the provision of minority equity participation in each development.

Question 4. How many RLA parcels are left to be sold and in which location? What development requirements will there be?

Answer. There are 66 RLA sites remaining to be sold. Of these, 27 sites have been committed to prospective developers as either an Exclusive Right or under a Tentative Designation. These developers are currently preparing plans for development. The remaining 39 sites are to be marketed as quickly as possible.

The RLA sites are shown by urban renewal project according to their status. (See Attachments.)

The capital expenditures of the City have skyrocketed in recent years. I have seen figures indicating that capital project appropriations for fiscal year 1981 were $188 million. The fiscal year 1982 budget requests $200 million. Meanwhile, the cost of borrowing continues to climb.

Question 1. What accounts for these massive capital funds?

Answer. The major recent causes of high capital spending by the District have been Metrorail, the Convention Center, and the crosstown water main. These three major projects are budgeted to spend $70.1 million in 1982.

Question 2. What projects could be cut back?

Answer. For fiscal year 1982 it was necessary to reduce proposed capital outlays by $74.4 million, from $219.4 million to $145.0 million. This was caused by a limit placed on the amount of Treasury Loans available to the District. A summary of the reductions is enclosed in Attachment No. 3. In some instances reductions in needed capital spending must be made by delaying or deferring construction until it is possible to provide financing.

Question 3. What projections are being made for 10 years down the road, when hopefully Metro, the Capital Center, and UDC will be completed?

Answer. The District currently plans capital improvement spending only six years in advance. It is expected that the volume of capital projects will be reduced when major projects now planned or underway are completed. However, because of inflation of construction costs, the actual dollars expended ten years from now will probably not be less.

Question 4. In an absolute cash storage, would you, as Mayor, halt capital projects before laying off firemen, policemen, and teachers?

Answer. Capital project cash and operating cash are kept in separate funds, and there should never be a choice between capital projects and payrolls.

ATTACHMENT I

Suggested Revisions to the Capital Improvements Program Priorities

1. Statutory/Code Requirements.—Priority projects necessary to comply with local and federal statues and codes. Also included in this category are projects required as a result of court orders. Examples of such projects are: Compliance with Smoke Detector Act of 1978; Compliance with Section 504 of Rehabilitation Act of 1973; Occupational Safety and Health Administration (OSHA) Compliance; Children Center renovations mandated by the courts, etc; Compliance with the federal Air Quality and Water Pollution Control Acts; Compliance with the D.C. Building and Housing Codes.

2. Basic Facility Improvements.—Priority projects necessary to keep the city's physical plant and facilities functioning. Examples of such projects are: water and sewer improvements, street improvements, roofing replacements, boiler replacements, heating and air conditioning systems replacements, etc.

3. Efficiency Improvements.—Priority projects that result in increased efficiency, and operating savings. Projects should also contribute to furtherance of city pro-

grammatic goals such as economic development, housing development, etc. Examples of such projects are: energy improvement, security systems, electrical modernizations, metering and automation.

4. Revenue Producing.—Priority projects which bring revenues to the City in the form of private investment leveraging, increases to the tax base, income generation by service charges or reductions in operating costs. Examples of such projects are: basic infrastructure in support of economic development projects, projects supported by citizen assessments, and projects with direct and/or indirect income generation resulting in increases to property tax, sales tax, income tax or other tax bases.

5. Program Space Improvements.—Priority projects that increase program service delivery capabilities without substantial requirements for additional staffing and maintenance. Examples of such projects are: modernization of labs, office space, police and fire stations; conversions to enable existing programs to vacate leased faciiities, etc.

6. Program Space Expansions.—Priority projects required to support new programs or new program space to be housed in existing facilities. Examples of such projects are: conversions of standard classrooms to libraries, media centers and science laboratories, new labs or garages with significant increases in square footage, etc.

Attachment II

Estimated Debt Capacity Including Effect of Deficit Bonds
(all amounts in $1,000,000)

		Fiscal Year				
		82	83	84	85	86
(A)	Debt Service On:					
	1. Existing Loans Made through FY 80	138.8	132.8	132.1	132.1	132.0
	2. Est. FY 81 Loans @ 133.3 @ 12.375% @ 30 yr.	-	23.6	17.0	17.0	17.0
	Subtotal	138.8	156.4	149.1	149.1	149.0
	3. Est. Deficit Bonds @ 185.0 @ 10.90% @ 20 yr.	23.1	23.1	23.1	23.1	23.1
	Total	161.9	179.5	172.2	172.2	172.1
(B)	14% of Estimated Adjusted "District Revenue"	230.0	247.0	262.0	276.0	293.0
(C)	Estimated Debt Service Capacity (B) - (A)	68.1	67.5	89.8	103.8	120.9
(D)	Estimated Cumulative Debt (New Issue) Capacity	591.4	786.9	909.6	1059.4	-

$$\frac{(1 + 0.109)^{30} - 1)}{(1 + 0.0109)^{30} (0.109)} \times (C)_{FY+1}$$

Assumes new capital funding FY82 through FY85 is provided by bonds, with level debt service at 10.90% for 30 years.

Attachment III

Summary by Agency of Capital Outlay Reductions for FY 1982

($ THOUSANDS)

	FY 1982 CIP	FY 1982 Revised	Increase (Decrease)
Department of General Services	$22,553.3	$4,810.3	$(17,743.0)
Police Department	3,053.5	1,403.5	(1,650.0)
Fire Department	2,857.2	1,349.2	(1,508.0)
Corrections	2,336.1	1,085.3	(1,250.8)
Human Services	2,315.3	1,064.5	(1,250.8)
Courts	1,137.1	523.1	(614.0)
Schools	8,844.7	5,794.7	(3,050.0)
UDC	531.3	-0-	(531.3)
Recreation	800.0	368.0	(432.0)
General Hospital	4,139.3	1,908.5	(2,230.8)
Library	1,041.0	491.0	(550.0)
Subtotal DGS	$49,608.8	$18,798.1	(30,810.7)
Business and Economic Development	$ 1,000.0	-0-	(1,000.0)
Housing and Community Development	$11,676.3	$ 6,525.9	$(5,150.4)
Environmental Services			
General Fund	5,496.7	4,455.9	(1,040.8)
Water and Sewer Fund	15,052.8	7,742.0	(7,310.8)
Crosstown Watermain	40,073.3	27,000.0	(13,073.3)
Subtotal DES	$60,622.8	$39,197.9	$(21,424.9)
Transportation	17,088.1	23,914.9	6,826.8
Metro	51,003.5	22,400.0	(28,603.5)
Convention Center	11,981.0	20,685.2	8,704.2
Washington Aqueduct	16,375.0	13,478.0	(2,897.0)
Total	$219,355.5	$145,000.0	$(74,355.5)

RLA SITES

A. Shaw School Urban Renewal Area

1. Sites to be Marketed

Parcel 13 (14th btwn U & V Sts., N.W.)	2.24 acres	Commercial use site
Parcel 19 (14th btwn R & Riggs Pl., N.W.)	.7 acre	Neighborhood shopping
*Parcel 23 (8th & O Sts., N.W.)	.5 acre	Medium density hsg.
*Parcel 25 (7th btwn T & Florida Ave., N.W.)	.5 acre	Mixed use-commercial/ medium density hsg.
*Parcel 30 (7th btwn S & T Sts., N.W.)	1.0 acre	Mixed use-commercial/ medium density hsg.
*Parcel 33 (7th and S Sts., N.W.)	.2 acre	Mixed use-commercial/ medium density hsg.
Parcel 38 (Corcoran btwn 13 & 14 Sts.)	.1 acre	Public park
Parcel 39 (10th & S Sts., N.W.)	.1 acre	low density housing
*Parcel 40 (7th and P Sts., N.W.)	.1 acre	Mixed use-commercial/ medium density hsg.
*Parcel 41 (7th btwn M & N Sts., N.W.)	1.1 acres	Mixed use-commercial/ high density housing
*Parcel 42 (7th & Rhode Island Ave., N.W.)	.4 acre	Mixed use/commercial/ high density & Shaw Health Center
*Parcel 43 (7th and S Streets, N.W.)	.2 acre	Mixed use-commercial/ high density housing

(*Plan change pending)

2. Committed Sites

None

B. 14th Street Urban Renewal Area

1. Sites to be Marketed

Parcel 11 (14th & Clifton Sts., N.W.)	.6 acre	Minor community service center-mixed use develop.
Parcel 12 (14th & Belmont St., N.W.)	.8 acre	Minor community service center-mixed use develop.
Parcel 13 (14th btwn Belmont & Chapin N.W.)	.9 acre	Minor community service center-mixed use develop.
Parcel 15 (14th btwn Irving & Kenyon)	1.4 acres	Major Community Service Center-mixed use develop.
Parcel 19 (Euclid btwn 13th & 14th Sts., N.W.)	.4 acre	high/medium density hsg.
Parcel 23 (Belmont btwn 13th & 14th Sts.)	1.1 acre	high/medium density hsg.
Parcel 32 (Chapin btwn 14th & 15th Sts.)	.3 acre	public/open space
Parcel 34 (14th btwn Belmont & Florida Ave.)	.4 acre	Special community street Mixed use/public use
Parcel 38 (14th btwn Kenyon & Park Rd., N.W.)	.2 acre	Special community street Mixed use/public use

Parcel 39 (14th & Irving St., N.W.)	.3 acre	Special community street - Mixed use/public use
Parcel 41 (14th & Kenyon St., N.W.)	.2 acre	Special community street - Mixed use/public use

2. Committed Sites

Parcel 5 (14th btwn Girard, Fairmont & Euclid)	4.8 acres	High/medium density housing
Parcel 14/28 (14th bwtn Park Rd. & Monroe St.)	1.2 acres	Major community center - Mixed use develop.
Parcel 24 (14th bwtn Monroe & Newton Sts)	.3 acre	" " "
Parcel 26 (14th & Irving Sts.)	2.7 acres	" " "
Parcel 27 (14th btwn Irving & Park Rd.)	4.9 acres	" " "
Parcel 29 (14th, Monroe, Park Rd. & Holmead)	2.8 acres	" " "

C. H Street Urban Renewal Area

1. Sites to be Marketed

Parcels 8 & 9 (13th & 14th on H Sts.)	2.8 acres	High & medium density housing
Parcel 19 (H btwn 7th & 8th Sts)	.2 acre	Special community street - commercial use
Parcel 20 & 21 (H btwn 11th & 12th Sts.)	.3 acre	" " " "
Parcel 22 (H btwn 12th & 13th Sts.)	.5 acre	" " " "

2. Committed Sites

Parcel 5 (15th & F Sts)	.95 acre	School site expansion
Parcel 6 (13th & Tennessee Ave.)	1.2 acres	School site expansion
Parcel 14 (btwn 3rd, 4th & H Sts.)	.8 acre	Medium density housing
Parcel 16 (H & 4th Sts.)	.1 acre	Special community stree - commercial use

Parcel 17 (H & 5th Sts.)	.4 acre	Special community street -commercial use/housing

D. Downtown Urban Renewal Area

1. Sites to be Marketed

None.

2. Committed Sites

Parcel 1 (K, 4th, L & 5th Sts.)	4.98 acres	Housing construction completed on Phase I
Parcel 2 (12th & G Streets)	.7 acre	Retail Core development
Parcel 3 (G St. btwn 12th & 13th Sts.)	1.4 acres	Retail Core development
Parcel 5 (12th & G Sts.)	1.6 acres	Retail Core development
Parcel 11B (M St. btwn 6th & 7th Sts.)	.3 acre	Church expansion

E. Northwest One Urban Renewal Area

1. Sites to be Marketed

Parcel 42 (N. Capitol btwn H & I Sts.)	.8 acre	Gonzaga expansion
Parcel 45 (N. Capitol & H Sts.)	11.8 acres	Public building site currently used by Government Printing Office

2. Committed Sites

Parcel 41 (New Jersey btwn H & I Sts.)	3.7 acres	School site-prevocational School for the handicappe
Parcel 44 (New Jersey, Mass, 2nd & H)	.8 acre	Office building headquarters, Union Labor Life Insurance Co.
Parcel 51 (H, 3rd, K & 2nd Sts.)	3.9 acres	Air rights development housing/shopping

F. Northeast No. One Urban Renewal Area

1. Sites to be Marketed

Parcel 8 (N. Capitol btwn M & Patterson Sts.)	1.0 acre	Commercial/manufacturing
Parcel 17 (N. Capitol & L Sts.)	1.3 acres	Commercial/manufacturing
Parcels 28-32, 34 & 35 (N. Capitol btwn [illegible] Sts.)	2.7 acres	Post Office expansion

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2. Committed Sites

Parcel 1 (N. Capitol btwn Patterson & N Sts.)	1.0 acre	Headquarters for Girl Scouts
Parcel 39A-1 (1st & L Sts.)	1.6 acres	Commercial/manufacturing
Parcel 20 (1st & H Sts.)	4.6 acres	Commercial

G. Southwest 'C' Urban Renewal Area

1. Sites to be Marketed

Parcel 36 (2nd & D Sts.)	1.1 acres	Community use - Architect of the Capitol has indicated interest in site
Parcel 43 (Canal St.)	3.0 acres	" " " "
Parcels 47 & 49 (12th, D, 14th & Maine Ave.)	10.7 acres	Second Commercial Prospectus responses due August 17, 1981

2. Committed Sites

Parcel C-2-B & C-2-C (Waterfront)	.44 acre	Commercial/waterfront related uses
Parcel D-2-B (Waterfront)	.4 acre	Commercial/motel
Parcel 27 (2nd, D 3rd & Virginia)	2.4 acres	Second Commercial - Housing site is in litigation

Senator MATHIAS. Our next witness is a representative from the U.S. Treasury, Mr. Mehle.

Mr. Mehle, you are the Assistant Secretary for Domestic Finance. Is that correct?

Mr. MEHLE. That is correct.

Senator MATHIAS. Are you available for counseling households?

Mr. MEHLE. I am having enough trouble with my own.

Senator MATHIAS. Do you have a statement?

Mr. MEHLE. Yes, I do; I would like to read it in an edited form.

Senator MATHIAS. You may summarize it as you see fit.

TESTIMONY OF ROGER W. MEHLE, ASSISTANT SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY, ACCOMPANIED BY DAVID HERSHIPS, DIRECTOR, OFFICE OF MUNICIPAL FINANCE, DEPARTMENT OF THE TREASURY

Mr. MEHLE. Thank you, Mr. Chairman.

Mr. Chairman and members of this subcommittee, I welcome this opportunity to convey to you the administration's views on S. 744, which would authorize the District of Columbia to issue up to $184 million in long-term debt to finance an accumulated deficit.

My testimony addresses two basic points. First, the administration strongly supports the District's efforts to manage its own finances pursuant to the provisions of the Home Rule Act, including—of special relevance to the subject of this hearing—the District's efforts to enter the long-term public marketplace.

Second, while the sale of long-term bonds to finance operating expenditures is generally and properly regarded as a questionable practice for State and local governments, a number of States and localities in recent years have used long-term bond issues to liquidate accumulated operating deficits.

In this regard, the conditions specified in S. 744 for such a bond financing are reasonable and the administration supports its enactment.

The District has been embarked on home rule for several years now and, despite difficulties, has made respectable progress toward self-sufficiency.

As a matter of principle, the administration believes that the District should be managing its own finances. In fact, the Home Rule Act already authorizes the District to issue long-term debt to meet capital-financing needs.

It is only because that act contains no express authorization for the District to finance current-account deficits or to pledge specific revenues to service its bonds that additional legislation is necessary in this case.

Mr. Chairman, this administration is committed to normalization of the District's financial relationship with the Federal Government. It supports a Federal payment that represents a fair and predictable contribution to the operating costs of the District government.

As you know, however, the administration has proposed to this committee that the District's extraordinary access to the Treasury for short-term borrowing be continued only for one more fiscal year, and that the Treasury be compensated for its cost of such short-term funds as are loaned in fiscal year 1982.

The administration has also proposed that the District's long-term borrowing from the Treasury be capped at $155 million for each of the fiscal years 1982 and 1983.

Beginning in fiscal year 1982, a one-half percent service charge—comparable with that charged other such borrowers—would be added to the appropriate Treasury rate on all District borrowings from Treasury.

After fiscal year 1983, the District is expected to have gained full access to the marketplace and no longer to require the authority to borrow from the Treasury.

The Treasury Department believes that the sale of bonds to finance current operating expenditures is generally not a wise policy for State and local governments. Indeed, it is rarely employed by such governments.

The unhappy exceptions—when the discipline of balancing the current-account budget is avoided—are well known. Long-term financing of current-account deficits is almost always a sign of fiscal difficulties and, unlike the legitimate financing of capital outlays by the sale of debt, it leaves future generations with higher tax payments but no commensurate benefits. Nonetheless, long-term deficit financing can be useful under appropriate circumstances.

A major objective of the current policy of the District is to enter the credit market for long-term capital financing. Two reasons lie behind this objective. First, dependency on the Treasury Department for its capital financing is a vestige of the prehome rule relationship with the Federal Government—a continuing reminder of the old days of dependency, the early termination of which is a logical and necessary step toward full home rule.

Second, long-term borrowing from Treasury is exceptionally costly. The District borrows at an interest rate roughly equivalent to Treasury's own borrowing costs. Sale of its bonds in the marketplace would permit the District to borrow at a tax-exempt rate, which could involve an interest rate as much as 20 percent lower than that paid to Treasury.

However, the District is unable at this time to proceed with its plans to enter the market to meet its long-term capital needs because its balance sheet is encumbered by an accumulated deficit. This deficit must be liquidated before access to the market for capital financing will be possible.

A number of options are available to the District for liquidating its accumulated deficit. These include increased taxes, reduced expenditures, and the sale of excess or underutilized property owned by the District.

The administration's view is, quite simply, that the authorization for the sale of long-term debt in the marketplace should be made available to the District as yet another option. The conditions specified in S. 744 for the exercise of this authority are reasonable. We believe that the decision on the option or options to be used to liquidate the deficit should be made by the elected officials of the District. In particular, should the District decide to exercise the bond-issuance authority, we believe that the marketplace is well qualified to judge the wisdom of the bond sale. In sum, the decision on the financing strategy should be made by the District, and the decision on the success of a bond sale by the marketplace.

The Treasury Department has one minor concern with regard to this bill. At this time, the Federal Government holds $1.5 billion in long-term debt of the District. This debt is secured by the District's full faith and credit but by no specific pledge of revenues or taxes.

Therefore, if the District were to dedicate a particular stream of revenues to the debt authorized by S. 744, the Federal Government would be effectively subordinated with respect to that revenue stream. This would be inconsistent with existing general policy to maintain the Federal Government's priority of payment. At this time, we are studying the situation in an effort to resolve this concern. As soon as an answer is available, the administration will be in touch with the subcommittee and the District regarding this matter.

In summary, the administration strongly supports the District's efforts to enter the bond market. The authority that would be granted to the District of Columbia government by S. 744 is a reasonable extension of that provided by the Home Rule Act.

The decision whether to exercise that authority should rest with the District government, pursuant to its plan to enter the public marketplace for all of its financing needs at the earliest possible time.

Thank you. That concludes my prepared remarks. I will be glad to answer any questions you may have.

Senator MATHIAS. Thank you.

You say that the administration has proposed that the District's long-term borrowing from the Treasury be capped. In other words, that Treasury borrowing should terminate?

Mr. MEHLE. That is right; in time.

Senator MATHIAS. You cite as one reason for capping long-term borrowing that it is expensive for the District to do business that way.

Mr. MEHLE. I was thinking of it in that sense as well as in the sense of the appropriateness of the District's continuing dependence on the Federal Treasury.

Senator MATHIAS. Suppose for one reason or another the reluctance of the Congress to pass this legislation or the fact that the bond market is less favorable—and preliminary estimates suggest that it will be. Under those circumstances would the Treasury maintain this position and insist on eliminating both the short-term and long-term borrowing authority?

Mr. MEHLE. I think that the attitude of the administration is the District should be doing everything it possibly can to stay out of the U.S. Treasury.

I think that it is also the case that the administration would not refuse to discuss these matters with the District should it turn out that they cannot gain access to the public marketplace either through the sale of bonds or through access to funds from commercial lending institutions.

Senator MATHIAS. Treasury suggested some increased interest rates, along with the eventual elimination of the borrowing authority. I do not want to see the District between Scilla and Caribidis in this business.

If these changes were made, would the Treasury be willing to say that they were contingent upon the city's success in entering the bond market?

Mr. MEHLE. I do not think we are in a position to negotiate in advance.

Senator MATHIAS. You may not be in a position to put the city between Scilla and Caribidis either. This is a situation where——

Mr. MEHLE. What we are trying to do, and what we want to do, is help the city.

Senator MATHIAS. I know what you want to do. I am sure it is to be constructive. But it seems to me that this is a situation where we are going to have to coordinate our efforts very carefully.

Mr. MEHLE. Yes; I certainly agree with that.

Senator MATHIAS. I would hope that you would think constructively about the relationship of the District's present borrowing authority in this transitional period.

Mr. MEHLE. Any increase in authority that they may be denied by the failure of the passage of S. 744—I certainly understand the issue.

Senator MATHIAS. And whether or not this special relationship is a desirable thing or not, it is a fact. It is an historic reality. In light of that historic reality, I think that you ought to consider whether or not you would be willing to subordinate the Treasury liens in order to facilitate success in this first appearance in the bond market.

Mr. MEHLE. Yes. We have considered that and have felt it would be an inappropriate thing to do. In fact, it would be unnecessary to the success of any District bond sale.

Senator MATHIAS. You say inappropriate?

Mr. MEHLE. Right.

Senator MATHIAS. Then I think that what this subcommittee is going to have to do is to cogitate as to whether or not the city will be able to enter the bond market coming in behind.

Mr. MEHLE. I do not think it necessarily has to be behind, but I do not think it can be in front of, which leaves only one other place to be, needless to say, arm in arm.

Senator MATHIAS. I was once a city attorney and I went through this bond process a number of times. Not many people are arm in arm.

Mr. MEHLE. My background, if I may, is as a municipal securities underwriter. I have spent a good deal of my professional career in developing securities offerings for municipalities.

I know, not only from my own background, but from current discussion, that the District could gain access to the marketplace with a parity position with respect to any dedicated revenues stream.

I think you would find that response one which would be joined in by securities professionals.

Senator MATHIAS. We have some other questions of a more technical nature which I would like to submit to you in writing. I will ask that you let us have your responses by the end of the week.

Mr. MEHLE. Certainly.

Senator MATHIAS. Without objection, so ordered.

We appreciate your being here. I look forward to some further conversations with you.

Mr. MEHLE. I would be delighted.

Senator MATHIAS. We would like to do something to help the District because I am really concerned about the kind of position they will be in and the kind of problem it will pose for the entire Federal Government.

Thank you.

[Responses of Mr. Mehle to written questions submitted by Senator Mathias follow:]

RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR MATHIAS

Question 1. It is apparent from your written testimony that we are all working toward the same goal—ensuring a fiscally sound District of Columbia. In that respect, would the Treasury Department be willing to work with Congress and the City to arrange a loan with a multi-year repayment schedule which could be used to retire the City's operating deficit? Or perhaps along with interest rates comparable to what the City would incur in the bond market, again with a multi-year repayment schedule?

Answer. The administration's general position with respect to the District of Columbia is strong support for its efforts to manage its own finances pursuant to the Home Rule Act. The time has come for the District to work out its financial problems, with a view to gaining access to the marketplace for its financing requirements, without the continuing involvement of the Treasury Department and the Congress. Thus the administration is generally opposed to an approach to the problem of the accumulated deficit that would involve borrowing from Treasury.

A substantial number of options are currently available to the District for resolving the deficit problem including, as I mentioned in my testimony, increased taxes, reduced expenditures, and the sale of excess or underutilized property owned by the District. If these options were extended to include an authorization for the sale of long-term debt in the marketplace, in accordance with the terms of S. 774, we believe that the District should be able to liquidate the accumulated deficit without further Federal involvement.

With respect to the second part of this question, I would note that the District's current authority for long-term borowing from Treasury to finance capital construction requires payment of an interest rate that approximates the rate being paid by Treasury at the time a loan is made. District borrowing at rates below Treasury's cost of funds would involve a subsidy. The general position of the administration is that Federal "subsidies" to the District should be made available only through the vehicle of the annual Federal payment (and through grant programs that are available to other State and local governments), and that special subsidies such as would be implicit in the long-term loan suggested by the question should be avoided. This is the reasoning behind the administration's proposal that—starting October 1, 1981—the District be required to pay interest at Treasury's rate on its short-term borrowings from the Federal government.

Question 2. With respect to the Treasury Department's proposal to add a one-half of one percent interest surcharge on both short and long-term borrowing authority of the District:

Would this surcharge be intended to cover Treasury's costs, or does it put the Federal government into a position of making a profit on these loans?

Are other Treasury customers charged a similar fee?

Is Congressional action necessary to allow this surcharge or is it something the Treasury Secretary could accomplish by regulation?

Answer. The 0.5 percent surcharge would more than cover the administrative costs of Treasury's lending to the District, but its purpose is not to make a profit. Other Treasury lending or guarantee programs calling for surcharges include the Federal Financing Bank (0.125 percent), the New York City Loan Guarantee Program (0.5 percent), and the Chrysler Loan Guarantee Program (1.0 percent).

The rationale for the surcharge on District borrowings is similar to the reasoning behind its use with Chrysler and New York City. Simply put, it is intended to act as an incentive for borrowers, which have been unable (for various reasons) to access the marketplace, to return to the market as soon as possible.

Congressional action would be necessary to authorize the imposition of the surcharge on the District.

Question 3. Your written testimony raises a very serious question regarding the marketability of the proposed bond issue under consideration by the Subcommittee. As you have noted, the City's full faith and credit has been pledged to secure the millions that the City has borrowed to date to fund capital improvements projects. Great care has been taken in drafting the legislation to ensure prospective creditors of the City that their investments are safe.

Can you postulate on the effect of the Federal government's prior lien on the marketability of the proposed bonds?

Will the City ever be able to enter the bond market as long as loans from the Federal government are outstanding?

If Treasury would not be willing or able to subordinate the Federal government's lien, what steps could be taken to ensure the success of the District's entry into the bond market?

Answer. The District of Columbia has outstanding, at this time, approximately $1.5 billion in long-term debt, which is held by the Treasury Department pursuant to Federal law. The debt is secured by a pledge of the District's full faith and credit. The District's financial advisers have argued that the marketability of the District's bonds would be improved by a pledge of a specific stream of revenue to the debt service.

The Federal government cannot accept in this instance, as a matter of principle, making the District debt it holds subordinate, or junior, to new debt the District might issue. This would violate sound financial practice as well as established policies against subordination. Treasury, however, does not insist on being senior to the new debt; a reasonable compromise for all parties would be a parity security status.

It is Treasury's view that new District bonds could be marketed pursuant to such a structuring. The District's outlays in fiscal year 1981 for debt service will be approximately $130 million. only 8.3 percent of its total general-fund revenues which are currently estimated to be $1.573 billion. By comparison, a recent survey conducted by the Joint Economic Committee and the Municipal Finance Officers Association indicates that the comparable ration in fiscal year 1980 averaged 9.8 percent for 34 cities with populations over 250,000.

Question 4. Matt Watson, former City Auditor, has made the point that the Federal Government should extend favorable treatment to the City because the District's major industry—the Federal Government—insists on being its own banker, thus keeping major amounts of money out of the normal municipal financial picture. Could you comment on this please?

Answer. I regret to say that the meaning of Mr. Watson's point is not apparent to me. The major basis for "favorable treatment" of the District—in the form of the unique Federal payment—derives from the exemption of Federal property from the real estate tax. As noted in my testimony, the Administration supports a Federal payment that represents a fair and predictable contribution to the operating costs of the District government, in recognition of the unique circumstances prevailing in the City.

Question 5. I understand that Treasury has some question about the City's cash flow and does not feel the City really needs $184 million. What projections does Treasury make for the City's cash needs?

Answer. The Treasury Department does not make projections of the District's cash flow. They are not required by any statute or regulation. Therefore, the Department has no formal position on the amount of financing the District needs.

Senator MATHIAS. The subcommittee stands adjourned.

[Whereupon, at 10:40 a.m., the subcommittee was adjourned subject to reconvene at the call of the Chair.]

DISTRICT OF COLUMBIA BOND AUTHORIZATION LEGISLATION

TUESDAY, SEPTEMBER 29, 1981

U.S. SENATE, SUBCOMMITTEE ON GOVERNMENTAL EFFICIENCY AND THE DISTRICT OF COLUMBIA, COMMITTEE ON GOVERNMENTAL AFFAIRS,

Washington, D.C.

The subcommittee met, pursuant to notice, at 10:12 a.m., in room 3302, Dirksen Senate Office Building, Senator Charles McC. Mathias, Jr. (chairman of the subcommittee) presiding.

Present: Senator Mathias.

Staff present: William Leonard, staff director; Eileen Mayer, chief counsel; Margaret Crenshaw, minority chief counsel; and Christine Sarcone, chief clerk.

OPENING REMARKS OF SENATOR MATHIAS

Senator MATHIAS. The committee will come to order.

This morning, the Subcommittee on Governmental Efficiency and the District of Columbia continues its hearings on Senate bill 744, a bill which would authorize the District of Columbia to issue and sell general obligation bonds for the purpose of paying certain liabilities of the District.

At a previous hearing on this legislation, the subcommittee heard from Mayor Barry and from the Assistant Secretary of the Treasury, both of whom favored the proposal.

Today we have three further witnesses. We will hear expert testimony from the General Accounting Office, from Arthur Andersen & Co., and from the city's financial advisers. I believe there are also some citizens of the District who wish to testify.

We will proceed with the first panel, which includes Mr. Franklin D. Raines of Lazard Freres, and Mr. Roswell Dikeman of Willkie, Farr & Gallagher. If you gentlemen will come to the witness table?

Let me welcome you and let me say to you—and in saying this to you, I also want to say to all others who propose to testify today—that your written statements will be included in full in the record. You may wish to summarize them briefly and then we have some questions we would like to ask you.

TESTIMONY OF FRANKLIN D. RAINES, VICE PRESIDENT, LAZARD FRERES & CO.; AND ROSWELL C. DIKEMAN, PARTNER, WILLKIE, FARR & GALLAGHER

Mr. RAINES. Mr. Chairman, my name is Frank Raines, and I am a vice president with the investment banking firm of Lazard Freres & Co.

Senator MATHIAS. Good morning, Mr. Raines. As I stated, your complete comments will be made a part of the record of this hearing.

Mr. RAINES. We have been the financial adviser to the District of Columbia now for slightly over 2 years. Our task in being hired by the District was quite simple, and that was to help them implement the provisions of the District Charter which permit them to borrow for capital purposes from the municipal bond market rather than borrowing from the U.S. Treasury.

The Treasury borrowing, historically, has been significantly more expensive than tax-exempt borrowing in the market and the District has estimated that its borrowing costs just for the last 2 years have cost over $87 million more by having borrowed from the Treasury than if they had borrowed in the municipal bond market.

As I point out in my statement, the first step that we undertook was to determine what the financial condition of the District was, since the market would require that the District have a strong financial position before bond buyers would be willing to buy bonds of the District to be repaid over a period as long as 30 years.

On examining the financial reports of the District, we, as well as others, found that contrary to what we thought—that the District under the supervision of the Congress had always had a balanced budget—in fact, the District had not had balanced budgets over much of the prior 10 years and had an accumulated operating deficit of $284 million. This operating deficit was a very serious problem from the standpoint of issuing bonds, because the bond buyer has to be concerned with whether or not the issuer of the bonds will be able to make the payments on a timely basis. This track record of a large accumulated deficit did not help in that regard.

There were other problems with the District pension program, which was severely underfunded, that would cause problems to a buyer of municipal bonds.

The District has proposed to deal with this problem in a manner not different from that of other municipal issuers who have acquired accumulated deficits, and that is, they proposed to pay those deficits off over a period of time, rather than leave the deficits unattended to.

This method has been utilized around the country and is almost always utilized where you have a very large accumulated deficit that cannot be repaid in 1 year or 2 years out of revenue, and that is what is proposed in S. 744.

The major problem of an accumulated deficit relates to how it affects the liquidity that a issuer has. And from a marketing standpoint, a bond marketing standpoint, liquidity is a very vital issue. If we look back to the case of New York City, New York City had acquired a $6 billion accumulated deficit but it was able to continue operations because it was borrowing $6 billion short term from

the market. At the point that the market determined—because New York City was not using generally accepted accounting principles at the time—at the time the market determined that this is what New York City was doing, it shut off access to borrowing as a liquidity device, and that meant that the city was in danger of shutting down, because, in fact, it was using borrowed funds to pay its bills from day to day.

The District has a very serious cumulative cash shortfall of at least, in our estimates, $313 million, based on their last audit, and what we would define as a minimum cash need of $184 million, the amount proposed to be issued in the legislation.

This cumulative cash shortfall equals about 17 percent of the 1980 budget and the minimum shortfall is 10 percent of the budget.

The municipal rating services, in judging the credit quality of an issuer, believe that 5 to 10 percent represents a cash crisis and clearly the District is in that realm.

Now, there has been some discussion that maybe this definition of cash need is too high. However, the market is not interested in simply bare cash sufficiency, that you just barely have enough money if you stretch, if you utilize gymnastics, to pay all your checks.

The market would like to see that the District has—and any issuer has—the cash available to pay its bills when they come due but have that cash prior to the due date.

If the District does not deal with at least the minimum cash deficiency, we are certain that the District will pay a significant interest penalty in its borrowing.

We agree with the program set forth by District officials and reflected in S. 744. We agree with it because we think it is the best way to handle the District's accumulated deficit, in the shortest period of time, and which will permit it to issue municipal bonds and thereby save District taxpayers an extraordinary amount of money.

Even when one considers the cost of issuing the deficit bonds, our analysis, along with that of the District, indicates that the net savings available to the District by being able to sell its capital bonds in the market, rather than borrowing from the Treasury, makes this plan cheaper than any other plan that has been proposed.

Also, the Treasury has indicated that they support this legislation, not, incidentally, because it would eliminate the District as a borrower from the U.S. Treasury and get it out into the private market. They have indicated that they have one minor technical concern with the bill which has to do with their precedence as a creditor.

Currently, the Treasury capital loans to the District are secured as general obligation of the District. But they also have additional security, which is the fact that since the Treasury pays the District the Federal payment, the Treasury is in a position to pay themselves should there be any question as to the ability of the District to pay it. And as a matter of practice, the Treasury has been paid from the proceeds of the Federal payment when it has been made available.

Therefore, the Treasury has, in our view, a prior position with regard to the Federal payment. All that S. 744 does is to provide a prior position with regard to a locally generated revenue to other lenders to the District, and we do not believe that this undermines the position of the Treasury whatsoever.

We do believe, however, that an automatic application of a Treasury equal priority would greatly endanger any capital program, and particularly one related to revenue bonds, since the revenue bondholders would never permit the Treasury, which has been issuing on a general obligation bond basis, to share whatever security they would have should they be lending to the District for water or sewer purposes. That would be a most extraordinary result and I don't think there is any example anywhere else in the country of it existing.

Mr. Chairman, let me just close my remarks with one final point concerning the timing of this legislation. In 1975, New York City was unable to borrow in the municipal bond market because of a $2 billion annual budget deficit and a $6 billion accumulated deficit. Immediately, the State legislature began to pass a series of acts to restore the financial viability of the city. The Congress of the United States also passed at least three major pieces of legislation, including a direct loan program and a guaranteed loan program.

This year, with all of that help, New York City has balanced its budget and regained access to the bond market.

In 1975, the District of Columbia also was unable to sell bonds in the market due to far less dramatic financial problems carried over from prior to home rule. Unlike New York City, the District, over 6 years later, is still unable to sell bonds in the market. Unlike New York, Cleveland, Detroit, the Chicago schools, or the city of Boston, the District has been unable to obtain the legislative authority it requires to solve its financial problem.

The Congress faces a fundamental question in considering S. 744. Does it wish the District to repay its accumulated deficit and meet its capital needs in the private market, or does it prefer to keep the District as a virtual ward of the Treasury and to continue to borrow for capital purposes at the higher interest rates that the Treasury charges?

As a financial adviser to the District, I am sure the District can survive under either system. But in fairness to the District, we believe it deserves to know exactly what the intent of the Congress is with regard to its future financial needs.

Senator MATHIAS. Thank you, very much.

Mr. Dikeman?

Mr. DIKEMAN. Mr. Chairman, my name is Roswell C. Dikeman. I am a partner of the law firm of Willkie, Farr & Gallagher, with offices located at 153 East 53d Street, in New York City, and at 818 Connecticut Avenue in Washington, D.C. We, together with the law firm of Hudson, Leftwich & Davenport, located at 1101 15th Street NW., in the District, have served as cobond counsel to the District of Columbia since the inception of home rule in January 1975.

My testimony will be related primarily to the technical provisions of S. 744, which was drafted by us at the request of the District. Incidentally, when I make any references in my testimony to actions taken by or opinions expressed by "us" or by "bond

counsel," it should be understood that I am referring to the joint action or opinion of both my firm and the firm of Hudson, Leftwich & Davenport.

Stated very simply, the purpose of the bill as drafted is to authorize the District to issue its general obligation bonds in order to finance a portion of the accumulated deficit in the general fund of the District as it existed on September 30, 1980. Since the bill is special purpose legislation—in effect, one-shot legislation—it was not drafted in the form of an amendment to the District of Columbia Self-Government and Governmental Reorganizational Act, the District Charter.

Section 461 of the District Charter, or the Home Rule Act, as it is also referred to, authorizes the District to issue general obligation bonds for various purposes such as refunding of outstanding indebtedness and to provide for the cost of acquiring or undertaking capital projects.

In the opinion of bond counsel, the authorization contained in this section clearly does not permit the District to issue bonds for the purpose of paying a general fund budget deficit. Accordingly, we have advised the District that congressional legislative authority is necessary to permit the issuance of bonds for this purpose.

As Mr. Raines has indicated, the issuance of bonds to fund budget deficits, as distinct from capital improvements, is not an uncommon practice. Unfortunately, perhaps, in recent years, such well-known issuers as the State of Connecticut, the Commonwealth of Massachusetts, the Chicago City School System, the city of Cleveland, the city of Yonkers, and New York City have issued debt for this purpose. Many other lesser known and smaller municipal issuers have also found it necessary to resort to this type of borrowing in recent years.

I mention this simply for the purpose of calling to the subcommittee's attention that this type of borrowing is not unique and that the market is accustomed to bonds being issued for this type of financing.

Section 3 of the proposed legislation authorizes the District to issue general obligation bonds for the general purpose of (i) paying eligible liabilities, as they are defined in the bill, (ii) reimbursing the general fund of the District for eligible liabilities that the District has already paid from other sources, (iii) providing for the payment of costs incidental to the issuance of bonds, and (iv) the funding of a debt service reserve fund if it is determined that such a reserve fund is appropriate as additional security for the bonds and if such reserve fund is authorized by the District Council in the bond act authorizing the issuance of the bonds.

The aggregate amount of bonds which may be issued is limited to a principal amount not exceeding $184 million, plus the costs incidental to issuance, and plus the amount, if any, needed to fund a debt service reserve fund.

The bill would permit the District to authorize bonds under its provisions by one or more acts adopted by the District Council in accordance with the usual procedures provided in the Home Rule Act. The one major exception is that the congressional review process, required with respect to other acts of the District Council under section 602(c) of the Home Rule Act is not applicable. In

other words, the bond act or acts enacted by the District Council would become effective immediately upon their enactment by the District Council, and their approval by the Mayor.

In addition to the preparation of the bond act, which will be a rather substantial document, a fair amount of time will be required in implementing the process of issuing the bonds by virtue of the fact that additional documentation will be required to satisfy potential underwriters and investors as to the security for the bonds.

Each bond act is required to set forth, in addition to the normal matters which one might expect, a plan for the financing of annual debt service on the bonds authorized by the act. This is a somewhat unique requirement and is designed to require the District Council to focus upon the manner in which the amounts required to pay debt service will be provided annually.

I should stress, however, that the future implementation of any plan set forth in the bond act is dependent upon additional actions as a part of the annual budget process, by the District Council, in future years, and as such, quite clearly the Congress will retain an oversight position with respect to such implementation.

My prepared testimony sets forth in detail some of the provisions which differ from the existing home rule provisions with respect to the authorization of the issuance of bonds. Other provisions of the bill which differ from existing provisions of the Home Rule Act are as follows:

One, the debt limit provisions of the Home Rule Act will not apply to the issuance of the bonds, nor is debt service on the bonds to be counted for the purpose of determining whether other general obligation bonds or Treasury capital project loans may be issued within the debt limit set forth section 603(b) of the Home Rule Act.

Two, the Mayor may sell any issue of bonds at either public or private sale.

Three, the bond proceeds must be deposited in a special bank account segregated from other funds of the District and may be expended only for the purpose for which the bonds were authorized, upon prior certification to such effect by the Mayor.

Four, any unexpended bond proceeds may be used only to pay debt service on the bonds.

Five, the District must account for all transactions involving bond proceeds, with such accounts being subject to audit by the General Accounting Office, the District of Columbia Auditor, and by independent auditors.

Six, the District is required to report annually to Congress on the use of bond proceeds and the payment of debt service.

Seven, the bonds may be additionally secured by a pledge of any District revenues.

Eight, the requirement for a prior congressional appropriation—I refer to the fourth sentence of section 446 of the Home Rule Act—does not apply to amounts obligated or expended from the bond proceeds; amounts provided for debt service on the bonds; or the pledge, transfer, or assignment of District revenues as additional security for the bonds.

Of major importance to the successful marketing of the bonds are the provisions of the bill which permit the District to enhance the general obligation security for the bonds by a pledge of District

revenues. This type of bond is commonly referred to as a "double-barreled bond," meaning that there are two sources of security, the general credit of the District and a stream of pledged revenues. The bill does not limit the District to pledging any particular District revenues, inasmuch as the selection of an appropriate revenue source should be a point of negotiation with potential underwriters to insure the most creditworthy debt instrument.

One other security device which should be specifically mentioned is the provision authorizing a funded debt service reserve. Such a reserve is not usually associated with general obligation bonds but may be appropriate for the double-barrelled type security contemplated by the bill as a hedge against a possible interruption in the flow of pledged revenues. I believe that current thinking tends to the view that such a debt service reserve fund will not be utilized. However, the feeling is that the authorization for such a reserve fund should be included in the legislation in the event that, a different conclusion for whatever reason, may be reached in the future.

A critical fact is assessing the marketability of the bonds is the fact that we, as bond counsel, have stated our willingness to render an unqualified opinion as to the enforceability, as well as the validity, under existing law of any revenue pledge additionally securing the bonds, without the usual bankruptcy exception.

This opinion is possible since the District is not subject to the provisions of chapter 9 of the Bankruptcy Code of 1978. Other municipal entities, other than States, are subject to such chapter.

Section 10 of the bill would authorize the District to additionally secure bonds by a pledge of District revenues. The Mayor is specifically authorized to sell any additionally secured bonds during the next 2 succeeding fiscal years at either a public or private sale in such manner as he may determine to be in the best interests of the District.

In recognition of the fact that this is a special purpose, one time borrowing authorization, section 11 of the bill exempts debt services on bonds issued pursuant to the bill from general debt limit calculations. This is provided on the theory that the funding of the budget deficit should not adversely impact the ability of the District to fund its ongoing capital improvement program.

Perhaps the most important provision in the bill, is section 12, which exempts appropriations for debt service on the bonds, the use of bond proceeds and the use of pledged revenues from the congressional appropriation process generally mandated by section 446 of the Home Rule Act.

Unlike provisions applicable to the payment of Federal debt, the Home Rule Act does not provide for an automatic appropriation for the payment of debt service on outstanding bonds of the District. Therefore, a District bondholder has no assurance that moneys will be legally available which are sufficient to pay the principal and interest on his bonds as they mature.

While it is unlikely that Congress would refuse to approve an appropriation for debt service, the possibility, although remote, that this could occur, or the more likely contingency that such approval might be delayed, would materially adversely affect the creditworthiness of District bonds. We believe that section 12 is

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absolutely essential to a successful marketing of the bonds authorized by this bill.

Section 13 of the bill, in effect, provides for an exemption of interest on the bonds from Federal and District income taxation, and makes the bonds legal investments for fiduciaries.

One key element which is missing from the bill which should be mentioned and which I believe was mentioned by Mayor Barry in his testimony on July 14, 1981, is the addition of a new section in the legislation which would clearly state that the credit of the Federal Government is not involved with respect to any bonds issued under the act and that the Federal Government will not be responsible or liable for the payment of such bonds at any future time. The House District Subcommittee has approved this concept and, as you perhaps know, has approved the addition of language in H.R. 1807, which would read as follows:

> The full faith and credit of the United States is not pledged for the payment of the principal or the interest of any bond issued by the District of Columbia under the authorization contained in this act. The United States is not responsible or liable for the payment of the principal or the interest on any bond issued by the District of Columbia under the authorization contained in this act.

While this language differs slightly from the language which we had suggested as a new bill section 11, we have no problems with the alternative proposed.

I think this states the proposition very clearly so that there should be no question as to congressional intent.

In conclusion, it is our expectation that the bill as drafted will furnish a legal basis for a marketable bond issue with an investment grade rating from the major rating agencies, without the interposition of any Federal assistance or guarantees, provided the District—and this is extremely crucial—demonstrates its ability to function within a balanced budget both currently and in the immediate future.

Senator MATHIAS. Thank you, gentlemen. As both of you have noted, the bill provides for an aggregate of $184 million in bonds. How did each of you arrive at that figure?

Mr. RAINES. The best way to look at the $184 million figure, Mr. Chairman, is through a set of charts I believe you have in front of you that we have prepared for the District. If you would turn to page 10 on those charts, you will see illustrated the financial results for the District in the general fund over a 3-year period beginning in 1978 and then proceeding to 1979 and 1980.

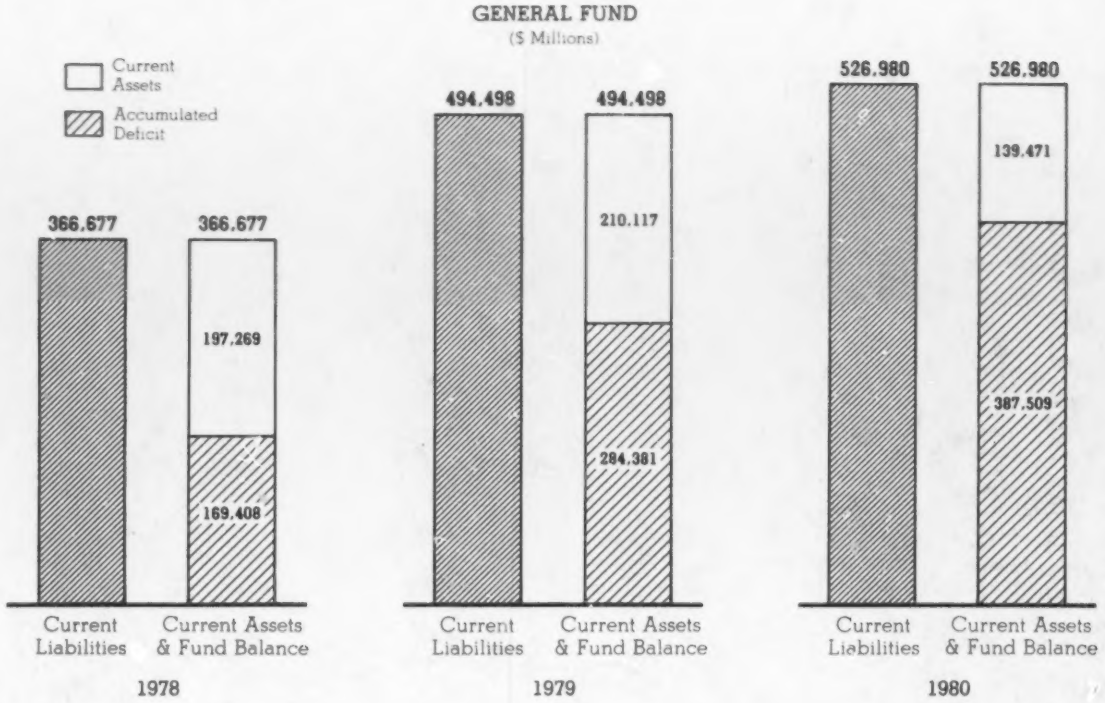
[The charts referred to follow:]

District of Columbia Liquidity Analysis

LAZARD FRÈRES & CO.

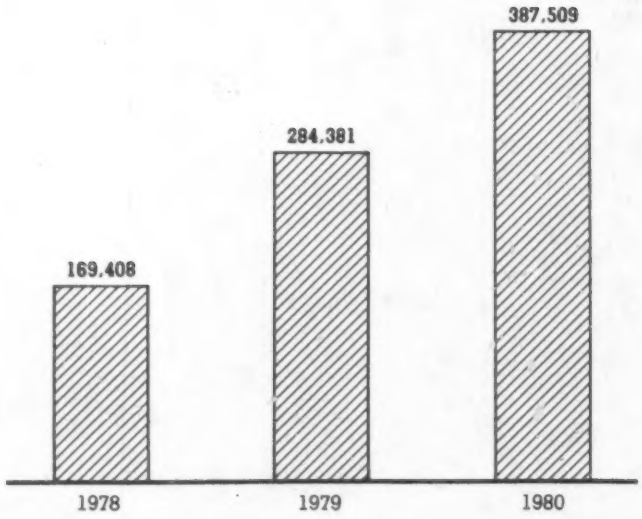
March 1981

Current assets should exceed current liabilities. The District instead has a significant accumulated deficit. That means it does not have sufficient assets to meet all of the obligations it has incurred over time.



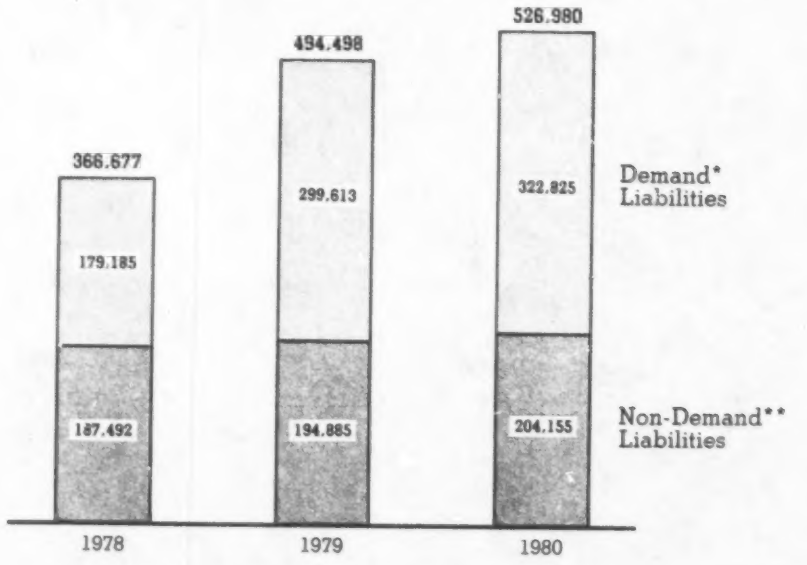
The accumulated deficit is the difference between current liabilities and the current assets available to pay them. The accumulated deficit has increased dramatically. A balanced budget will prevent a further increase in this deficit.

General Fund
ACCUMULATED DEFICIT
($ Millions)



Over the past three years current liabilities have increased substantially. Not all liabilities require cash payments in the relative near future. Those that do are called demand liabilities. Non-demand liabilities have increased only slightly.

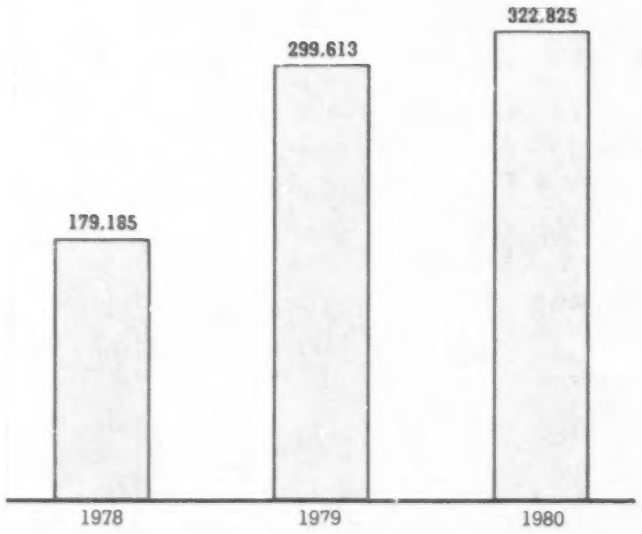
General Fund
CURRENT LIABILITIES
($ Millions)



*Includes accounts payable, accrued payroll, short-term advances, grant advances, judgements, Medicaid payables and other payables.
**Includes interest on Treasury debt, accrued leave and advance tax collections.

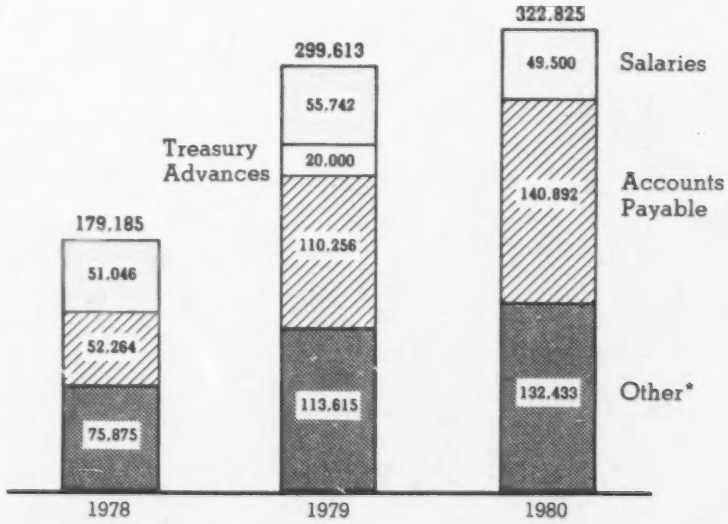
Demand liabilities requiring cash on hand have increased significantly over three years

General Fund
DEMAND LIABILITIES
($ Millions)



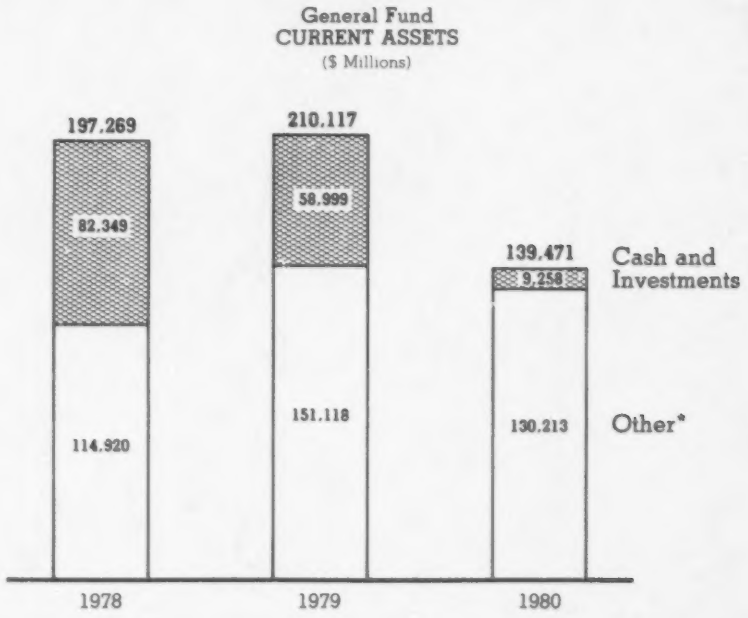
There have been increases in virtually all the demand liabilities. Most striking are the substantial increases in accounts payable and other* liabilities, through which most of the additional accumulated deficits have been financed.

General Fund
DEMAND LIABILITIES
($ Millions)



*Includes medicaid payables, tax case judgements, grant advances, and other current liabilities.

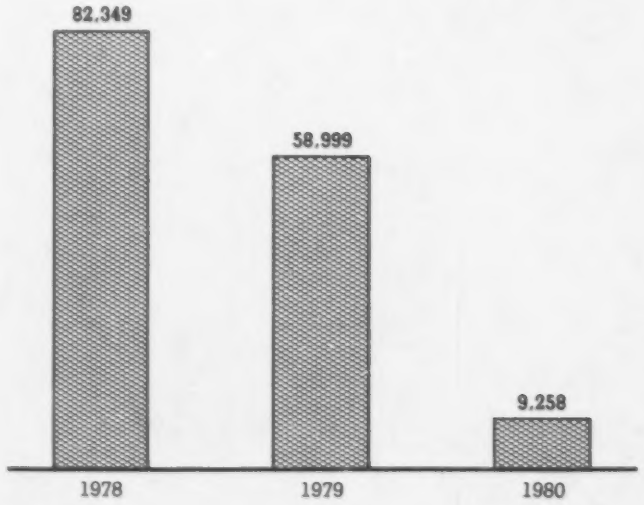
Current assets to meet current liabilities have declined significantly



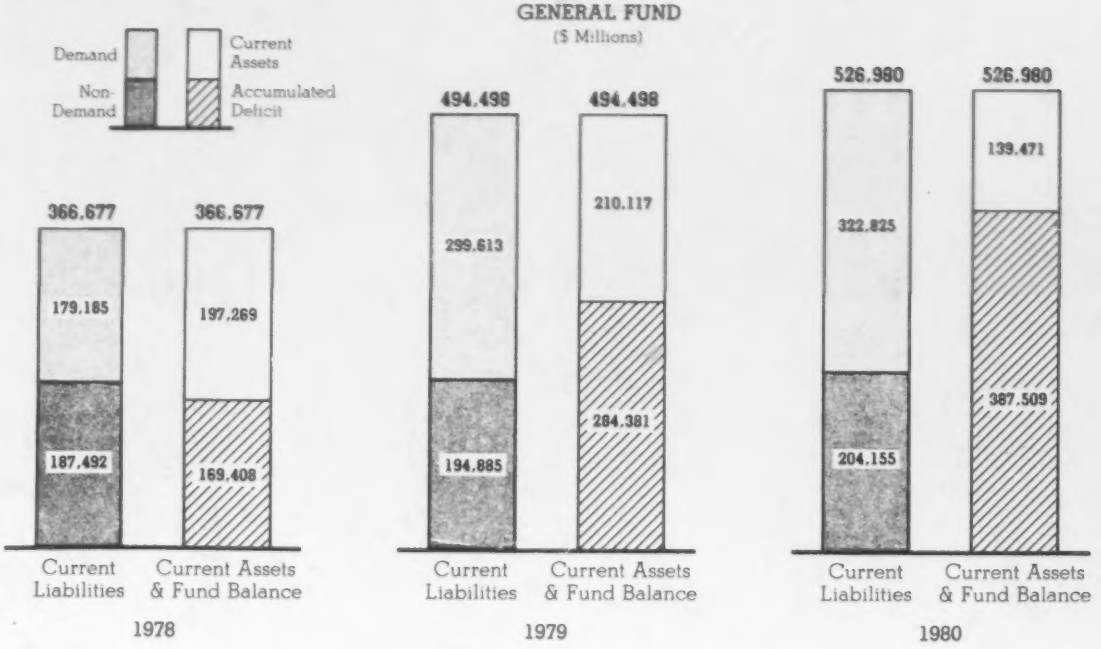
*Includes receivables, inventory, and others.

Cash and investments have declined by 89%

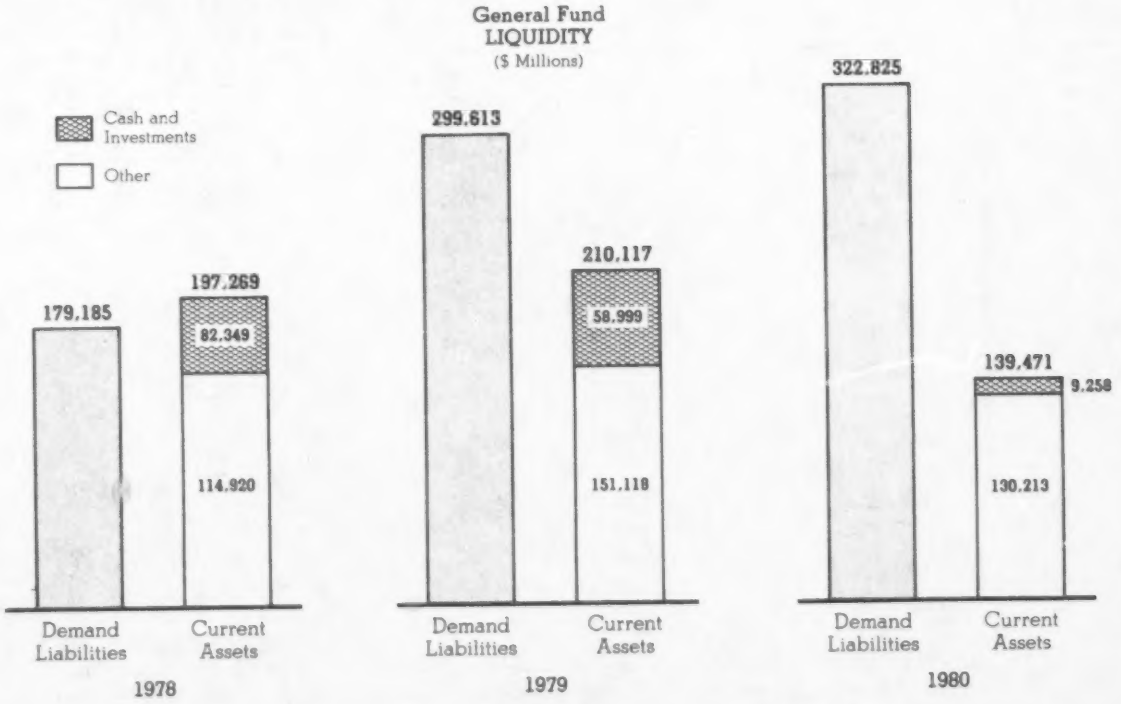
General Fund
CASH AND INVESTMENTS
($ Millions)



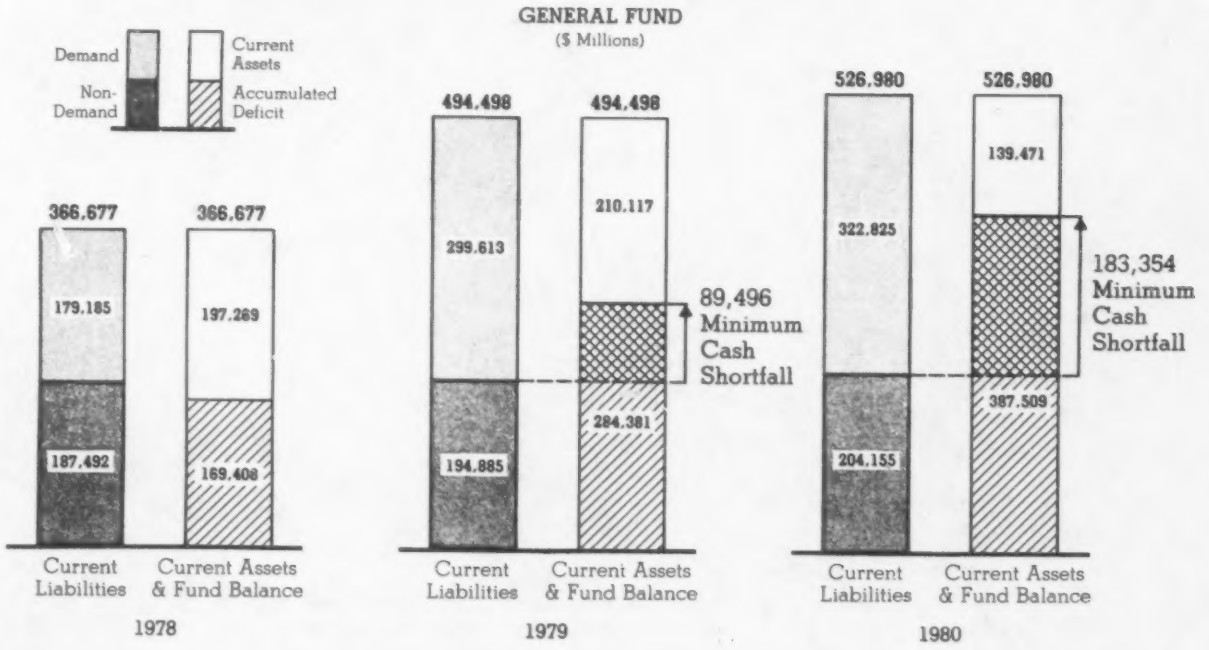
An accumulated deficit always requires financing of some kind. In 1978 the deficit was financed by offsetting non-demand liabilities. By 1979 the deficit was being financed by the equivalent of short-term borrowing from those holding demand liabilities.



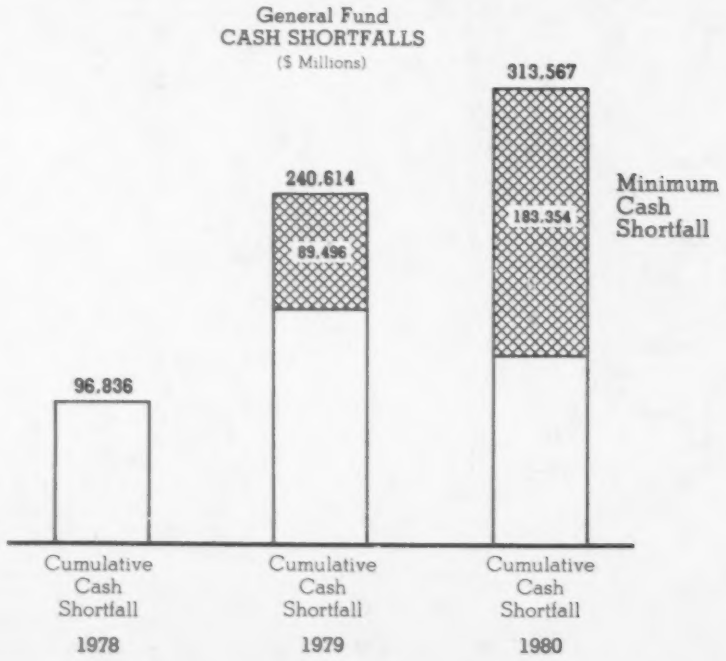
Liquidity is a measure of the ability to meet financial obligations in a timely manner. Current assets should exceed demand liabilities. In fact, cash and investments should at least equal demand liabilities. The general fund has developed a serious liquidity problem.



The amount by which the deficit exceeds non-demand liabilities is the minimum cash shortfall. A cash infusion to meet this shortfall should be long-term rather then short-term.



The cumulative cash shortfall is the difference between demand liabilities and cash and investments on hand to pay them. Because demand liabilities have been growing and cash has declined the general fund had had its cumulative cash shortfall triple in three years. The minimum cash shortfall takes into account other non-cash current assets. The District seeks to borrow an amount equal to the minimum cash shortfall. The remaining cash shortfall is to be funded from revenues over a period of years.



Mr. RAINES. What these two bars attempt to demonstrate is a comparison of liabilities against assets, but not merely comparing all liabilities against all assets, but looking at those liabilities for which there will or could be a demand for payment very quickly against those assets that you have to pay that demand.

That is the top part of each of those bars. If you look, in 1980 you will see in the top gray area, under current liabilities, there are $322 million of current liabilities which we would define as demand liabilities. I can go into exactly which ones they are but they are ones which you are going to have to pay out very quickly, within the next 30 to 60 days.

If you go over to the assets side, as a general rule, in credit analysis, you ought to have as much money in current assets, which means assets that you are going to realize within the next 30 to 60 days, as you have in demand liabilities.

Well, the District of Columbia only had $139 million in current assets, which leaves that shortfall, which we rounded to $184 million, of $183,354,000.

On a purely credit basis, even that slightly understates the need because generally you ought to have as much cash as you have demand liabilities, since some of your current assets may not in fact arrive within the next 30 to 60 days. So that $184 million is what we define as the minimum cash shortfall. The maximum cash shortfall would be the difference between cash and demand liabilities which is a much larger number.

Now, it is possible to say that, well, could you get by with less than $184 million in cash, and that would be possible if you cut it down to the bare minimum that you would need. But then any creditor would have to look and say, well, what happens if a big taxpayer doesn't make a tax payment on that date? What happens if they are 30 days late? Are you assuming here that you are going to be doing short-term borrowing, and if you are doing short-term borrowing, why should I depend on your ability to get someone else to lend to you in order to pay me or to pay your other creditors.

The credit agencies will look at this chart that we have here and we believe that they will accept the $184 million as being a sufficient number because we do meet the total minimum cash need, even though we don't meet the total cash need as they would define it.

Mr. DIKEMAN. Mr. Chairman, I don't think there is much of anything that I can add to that except to mention that it is not technically correct to say that the bill limits the amount of bonds issued to $184 million. It is $184 million plus the incidental expenses of the issuance of the bonds plus the debt service reserve.

Senator MATHIAS. As you have described, the way the figure of $184 million was arrived at, there is a certain philosophical position required, a certain approach. Has there been any agreement or disagreement in arriving at this figure? Are there people who would like to have a different philosophical approach to the problem?

Mr. RAINES. Mr. Chairman, yes. We have heard both sides. We have heard those who say, you don't really need $184 million, you could get by with less. And we've heard others who have said, you really should be getting more than $184 million. You should be

getting more like $313 million, which is your total cumulative cash shortfall.

Those voices that we have heard from the marketplace have tended to be at the number $184 million or higher. Those voices that we have heard from the Government sector have tended to be at $184 million and lower.

The market is the one that is expected to buy these bonds and to assume 100 percent of the risk of their not being repaid. We believe that the $184 million number sufficiently satisfies the needs of the bond purchaser and that there is no need to go higher. But, if the number is substantially lower, in that it does not really deal with the cumulative cash shortfall, then I think that it will result in a lower credit rating for the District bonds and perhaps might impede our ability to sell them at all.

Senator MATHIAS. Staying with your charts on page 10, the total deficit in 1980 would be rounded off to $388 million.

Mr. RAINES. Yes.

Senator MATHIAS. If the city is able to successfully market bonds for $184 million, how do you propose to cover the excess deficit?

Mr. RAINES. The Mayor's proposal is to set aside in the budget every year, for the next 20 years, $10 million that will be used to eliminate the remainder of the deficit.

Senator MATHIAS. I hope that is easier for the District than it is in my household. Setting aside money each year is a laudable ambition but it is one that is very hard to achieve.

Mr. RAINES. Well, one of the ways that we hope to do that, and that's one of the provisions in this bill, is the District would pledge to these bondholders to do so and therefore it would be a legally binding obligation on the District. It is similar to the way with our home mortgage, that we might have difficulty getting our tax money available and that's one reason the savings and loan sets up an escrow to make sure that you set it aside each month.

But your point is a very good point.

Senator MATHIAS. Yes, but when the savings and loan sets up the escrow, they collect it each month. It isn't a voluntary set-aside.

Mr. RAINES. We may well be setting up that similar kind of mechanism.

Senator MATHIAS. Well, that is why I am asking you about it.

When you mail in your monthly mortgage payment, that includes your taxes and your insurance and all of those things, and they hold it. You don't hold it because if you put it in the sugarbowl and the kids came around and wanted to go to the movies some night, why, maybe then you might be forced to dip into that bowl.

Mr. DIKEMAN. Mr. Chairman, undoubtedly the legal structure of this bond issue, with the contemplated pledge of District revenues as additional security, will include provision for a trustee and a trust indenture which will have to be drawn in such fashion as to assure the bondholders that there will be adequate means to enforce the integrity of the pledge and the covenants of the District.

Senator MATHIAS. Well, that is what the subcommittee wants to hear. We want to know exactly how this is going to happen.

Mr. DIKEMAN. Well, there will be no sugarbowls. There will be a trustee who will be a bank who will have physical custody of the

money. And it will not be a voluntary arrangement where the District has the power to either set aside the money or not as it may wish. Rather, the District will be compelled to do so by virtue of its legal obligations. In the event they do not, there will be an adequate mechanism provided for legal enforcement of those obligations on behalf of bondholders.

Mr. RAINES. Mr. Chairman, your general point is, though, I think the fundamental issue in this bond proposal. The major alternative proposals that we have heard call for the District to voluntarily set aside $30 million a year for *x* period of years until the deficit has been repaid. A bondholder, who has far less experience with the District than you, would be highly skeptical about buying bonds today on the promise that the District would pay off the deficit tomorrow. And that's why this proposal says, pay off the deficit today, and then go forward immediately thereafter with your capital bonds, which is the reason all of us are here, not for the sale of deficit bonds, but for capital bonds. Go out with that, after you have paid off the deficit.

And that is the key question. Why should we believe that any elected body will set aside extra money for 30 years to pay off old debts? The only reason that anyone has found for them to do so is that they have entered into a legally binding agreement with bondholders, that is legally enforceable, and in that case there has never been a question.

There hasn't been a major issuer of municipal bonds that has defaulted on bonds since the Depression. The problems that cities get into, and the problems that states get into, is when they rely on short-term debt and try to put off to another day the day of reckoning with regard to their deficits.

Mr. DIKEMAN. May I say also, Mr. Chairman, that as I know from previous experience, the underwriters and prospective investors are going to be much more skeptical than Congress of the ability of the District to live up to its obligations. To satisfy their skepticism and to enduce them into buying the bonds, we will have to put together a very rigorously controlled financial setup that will satisfy them that they will be paid on time and that the District will live up to its obligations.

Senator MATHIAS. Let me request that when that instrument is drawn up that this subcommittee be provided with a copy of it.

What is the effect on marketability of this excess deficit? Assuming you have now, not the sugar bowl, but an escrow arrangement.

Mr. RAINES. We think that it will mean that the District's first credit rating will not be as high as the District's credit rating will be as it pays down the rest of the deficit. It means that there will be somewhat of an interest penalty by not paying it off immediately.

Senator MATHIAS. It has a depressing effect?

Mr. RAINES. It is a negative factor. The market would prefer that whatever was done would pay for all deficits that have been found. We think that that is not required and we think that the tradeoff between what the negative effect would be and what the cost would be of going forward with $300 million worth of bonds leads us to believe that the $184 million is the most cost-effective way for the District to go forward.

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Senator MATHIAS. Now, you said there was some disagreement in the computation of the $184 million figure. Of course one of the most formidable opponents of that figure is the General Accounting Office, and I am sure you are familiar with the General Accounting Office position. How do you counter that?

Mr. RAINES. Well, I think we are asking two different questions. The question that they ask, and they have in the attachment to the statement provided to the subcommittee, is, what is the amount of cash that the District needs to meet their bills as they come due? And in doing so, they suggest that the ideal way to do that is to look back at the cash flow for the District in the prior 3 years and determine what was the gap in any given month, or any series of months, between cash that came in the door and cash in the bank and what the bills were in that month.

Now, that approach——

Senator MATHIAS. I'm worried about that approach.

Mr. RAINES [continuing]. That approach, from the standpoint of a treasurer, is exactly what you would try to do, because what you would be trying to do is to take any additional cash and invest it and make money.

But look at it from the bondholder's perspective, what we always define as the little old lady from Dubuque. She has to ask the question, What happens if the Federal payment is late one year? What happens if the council doesn't enact the provisions for the property tax because of a dispute? And all of the revenue is suddenly off by 1 month or 2. From her standpoint that means that you may then not be able to pay the bonds because in that month where you thought you were just meeting it, $5 million off means that somebody doesn't get paid. And they would say, well, who would they pay? Will they pay the little old lady from Dubuque or will they pay the policemen?

And so, what would the credit market say? The same thing they say to us individually and what they say to corporations, that we cannot simply—you can't simply have the bare amount of cash. You've got to have more.

In the corporate sector, the general rule is that current assets should be twice as great as current liabilities All we are trying to do is, over a period of time, get to the point where current assets equal current liabilities. We think that on that basis we can argue that the District can meet all of its financial obligations.

The other side of this too is the assumption of keeping it close assumes that there is somebody out there who is going to take care of you if you happen to be a little bit short. And in the District's case, that has been the U.S. Treasury which has been prepared to make cash flow advances.

Senator MATHIAS. And never bounced a check.

Mr. RAINES. We don't expect that that ability will last forever and nor will the bondholders because the Congress, any day of the week, could change that law. And so the bondholders can't assume that the Treasury will always be there to make an advance if the District is short. So they say, let's apply the same standards that we apply to everybody else. And the standard they apply to everyone else is that current assets ought to equal current liabilities, at

a minimum. And that is where this proposal tries to get the District to.

Senator MATHIAS. The fact that the General Accounting Office doesn't agree with you doesn't help any, does it?

Mr. RAINES. It only hurts on Capitol Hill.

Senator MATHIAS. You don't think it will hurt in the marketplace?

Mr. RAINES. No, sir, because the marketplace will make its own judgment. They won't listen to me either, but what they will do is, they will examine the books, and they will come to their own conclusion. All I am reporting to you is what conclusions they have come to in other cases. They will place reliance on the fact that the District has audited financial statements, audited by a nationally recognized accounting firm utilizing generally accepted accounting principles. Generally accepted accounting principles are different from the accounting principles utilized by the Federal Government. And the Federal Government's accounting principles are not recognized in the municipal bond market because they are not the traditional accounting principles utilized.

So that what they will do is, they will not look at my charts, they will not listen to my analysis. What they will do is look at the audited books of the District. They will draw their own chart and they will make their own determination. All I have tried to do is to utilize the analysis that they use to indicate to the committee what we think the kind of conclusions are that they will reach. But we, at that point, will be an advocate on behalf of the District. We will not be able to dictate to the rating agencies exactly what kind of an approach they will use.

Mr. DIKEMAN. I think you could say in summary, Mr. Chairman, perhaps the approach of the General Accounting Office is the traditional Federal Government approach to finances whereas the approach of the marketplace is somewhat different, attuned to some different factors, and indeed, if you utilize their approach, it would probably have a very significant adverse effect on the marketability of the bonds.

Senator MATHIAS. But you, as the bond advisers to the District, are not prepared to give weight to their contentions?

Mr. DIKEMAN. I am the District bond counsel—their lawyer in this matter. Frank is the financial adviser. Since the question falls within the financial adviser area, I will defer to Frank's response.

Mr. RAINES. Mr. Chairman, the one thing that has come from the debacle in New York City has been that the market will not accept an issuer having a unique means of accounting. Prior to 1975, very few local or State governments reported their financial results according to generally accepted accounting principles. Since 1975, the trend has been entirely in that direction.

A number of States have set up accounting rules for their cities and those accounting rules do not meet generally accepted accounting principles. The rating agencies want one set of standards and Standard and Poors has said that if you report your results according to standards different from generally accepted accounting principles, you must also give us your results according to generally accepted accounting principles.

From the standpoint of the market, they would look upon the General Accounting Office's analysis as being equivalent of a State having its own unique rules and they would say, that is fine. Give us what your unique rules are, but at the same time, give us your results under generally accepted accounting principles. So that we expect—and I say this with 100 percent confidence—that they will rely on the report of the independent auditor, because it was done on a municipal accounting basis, and not done on the Federal accounting basis.

The fundamental reason why they are going to do that, is that the United States can borrow anytime it wants to as long as it is willing to pay the price, because ultimately it is a riskless transaction for the lender. But that is not true of States and it is not true of municipalities. And therefore the accounting basis that the Federal Government uses is different because it assumes access to the market, whereas the accounting basis of every other entity in the country, whether it is public or private, cannot assume access to the market. It has to assume that it is going to have to have a certain credit ability before it will have access and that is what generally accepted accounting principles are meant to illustrate, your real condition in order to let the credit analysts apply their various tests to determine how creditworthy you are.

Senator MATHIAS. Well, accepting what you say, the fact is that most municipalities don't have a conflicting General Accounting Office opinion floating around.

Mr. RAINES. Sometimes they do. There are State auditors who come in and they will do an audit according to the State rules and then the municipality will then report according to generally accepted accounting principles and they will make both available.

Senator MATHIAS. With all due respect to State governments, I would not put State auditors in the same category as the General Accounting Office.

Mr. RAINES. I was previously in the Federal Government and I have a great respect for the General Accounting Office and the people there and we had a great deal of dealings with them. All I am suggesting is that their chore, given to them by Congress, is different from the chore given to the District as a municipality.

Senator MATHIAS. I agree with that, but I was previously in municipal government and I know some of the problems you face in this area.

There is a certain amount of poetry in the choice of this day for this hearing. This is the last day but one of the fiscal year, and it is obvious that in the next 24 hours we aren't going to issue any 1981 bonds. You would agree with that?

Mr. RAINES. Yes, sir.

Senator MATHIAS. So, my next question is, what effect will these have on your recommendations?

Mr. RAINES. Mr. Chairman, I think there may be two parts to your question. One is, if the District finished this year, why do they need these bonds? The District finished this year by borrowing $80 million from the Treasury, on a short-term basis, which they will repay tomorrow. Without that $80 million, the District would have been unable to meet its financial obligations. The second question

is, the real issue here isn't a matter of, will the District collapse on any day. As long as the Treasury is prepared to lend to the District short-term, it will never collapse. The District will be able to go on forever.

That's really not the question, I think, that is before the subcommittee. The question before the subcommittee is, in the future, should the District borrow from the Treasury for all of its purposes, or should it be cut off and sent to the market to borrow? The District has assumed that the Home Rule Charter intended, the intent of Congress, and clearly the intent of this administration, is for the District to stop borrowing from the Treasury at some point.

The only effect of this bill is to permit the District to stop borrowing from the Treasury, to borrow from the market, and to do so cheaper. The market simply has higher standards than the Treasury. The Treasury will lend to the District in good times and bad times. The market will only lend to the District in good times. Therefore the District has to produce those conditions of good times.

I think that they have gone a long way. The District was running deficits in virtually every year of the last 10 years. I think you will find that at the close of this year, the District will have a balanced budget.

The District has had an escalating accumulated deficit. The accumulated deficit will not escalate this year. In fact, it will probably be reduced somewhat.

The District has taken a wide variety of steps, from layoffs and other maneuvers, which have produced a balanced budget. The District has, in our view, done all the things that we have asked them to do to get into financial shape. They have balanced the budget and they have pledged to continue to balance the budget.

What's needed is to take care of the past problems. The current situation is stable and we believe in good shape. The past problems are what is hanging around the District's neck and pulling it down.

But should the subcommittee, and should the Congress, decide that the District borrowing from the Treasury is fine, and that you have no problem with that, you do not need to pass this legislation, because it is only required to meet the requirements to get the District into the private bond market.

Senator MATHIAS. When we close the books tomorrow, will it change the minimum cash needs or will they still be the same?

Mr. RAINES. When the audit is completed on February 1, we would anticipate that the minimum cash needs will be no higher than they are now and possibly lower, hopefully lower. Our anticipation is that if the Congress enacts this legislation in the near future we will be able to sell the first bonds immediately after the audit is available in February, which will, in our view, hopefully demonstrate that the District has balanced its budget and will give us fresh numbers because these numbers that we use here are already 1 year old. This will give us fresh numbers as to what the minimum cash need is.

Senator MATHIAS. What is your advice as to the term of the bonds?

Mr. RAINES. We believe the term of the bonds ought to be as short as possible. The maximum term that we have advised the

District they ought to consider is 20 years, at this point, and the minimum is, what can the budget afford in any particular year. By definition, by using bonds, we have come to the conclusion that they can't be paid off immediately, so there must be some period of time. I would hope that we would be able to have them be shorter than 20 years and be able to pay back the bonds in a shorter period of time.

Mr. DIKEMAN. Incidentally, Mr. Chairman, it is anticipated that we will include in the bonds an appropriate call provision permitting the District to accelerate the maturity of the bonds within the limits of what the market will accept, accordingly the District would be in a position to accelerate the retirement of bonds within budget constraints.

Senator MATHIAS. You referred to the cost of issuing the bonds. What do you estimate those costs to be?

Mr. DIKEMAN. We are talking about a relatively insignificant amount. I have not attempted to make any calculations in that regard. The major components of that category of expense include the usual items such as printing; advertising; professional fees, including both Lazard Freres and my firm; and the underwriter's discount, which would probably be the most significant item. It is difficult to estimate a total figure because of the uncertainty of what the underwriter's discount may be which depends on circumstances at the time of marketing.

Senator MATHIAS. What would be, in your judgment, a profitable underwriter's discount?

Mr. DIKEMAN. For a 30-year term?

Mr. RAINES. Part of our job, when we get to issuing bonds, is to make sure that the underwriter's discount is as small as possible. My guess would be that the underwriter's discount would be in the range of 2 to 2½ percent of the total issue, and that the rest of the expenses would not exceed another one-half of 1 percent, in total. So that, somewhere between 2½ and 3 percent would be a ball park. If we have a more favorable market, we would be trying to push that discount down as far as possible and thereby save the District money.

Senator MATHIAS. What is the standard bond counsel's fee?

Mr. DIKEMAN. Well, we will be handling this transaction on a combined-charge basis which will have two components, one based on the amount of the issue and the other based upon——

Senator MATHIAS. A percentage of the issue?

Mr. DIKEMAN. Right. Probably something in the neighborhood of 30 cents for $1,000 principal amount of the bonds. This figures out to about three one-hundredths of 1 percent, if my decimal point is in the right place. The other component is the time expended, and that would be charged at an agreed-upon hourly rate.

Senator MATHIAS. I see. We'll release you from the witness box at once to save money. You've got that meter running.

Mr. DIKEMAN. I don't have my stopwatch on.

Senator MATHIAS. One of the expenses you haven't mentioned is the traditional visit of the municipal officials to the city of New York to sign the bonds.

Mr. DIKEMAN. Oh, yes.

Senator MATHIAS. This always requires an overnight trip, in my experience.

Mr. DIKEMAN. I can see the Senator is experienced in the municipal bond market.

Mr. RAINES. Although we should note that the legislation, I believe, only calls for one signature on these bonds.

Senator MATHIAS. The municipal official who goes can never go alone. I don't think it has ever happened in the history of municipal bonds.

Mr. DIKEMAN. Of course, I might note, Mr. Chairman, the traditional closing dinner is an expense of the underwriter.

Senator MATHIAS. The cost of extended term is substantial. What would be the difference, say, between a 5-year bond and a 20-year bond? Take a $1,000 bond, just as a hypothetical case.

Mr. RAINES. It's a very hard question. Right now I would estimate, assuming an A-rated bond, a 20-year A-rated bond—not having spoken to anyone in New York today on where the market is—a general obligation bond would probably be in the neighborhood of 12½ percent, 12½, to a maximum 13 percent. A 5-year bond, today, would be—I would just be guessing because it is so rare that we have any in any size in 5 years--but it would be somewhat less than 10 percent. The repayment, however, would more than double, so that instead of expecting a repayment in the $20 million to $30 million range, you would be seeing payments in the $40 million to $60 million, maybe as much as $65 million. I would have to get my calculator out to give you an exact number. But the budget impact is dramatic by shortening the length of the bonds. Generally, though, you will get a lower interest rate.

It's equivalent to having a 20-year mortgage on your house, or a 5-year mortgage in which you have to pay it all off in 5 years.

Senator MATHIAS. It impacts on you very rapidly?

Mr. RAINES. Very rapidly. Very hard.

Senator MATHIAS. Is there any difference, or will you anticipate any difference, in the rating of these bonds and classic capital improvement bonds?

Mr. RAINES. I would think that since this is the District's first time in the market and because the District has had some financial difficulties, that the District's first rating will not be as high as later ratings. The rating will have much more to do with the fact of the budget deficits than the fact that these are deficit bonds.

After the District has had two, three, four balanced budgets in a row, its rating will naturally go up because the rating agencies now have a track record of the District having balanced its budget.

In the first year, they will only have 1 year to go by.

Senator MATHIAS. If the Senate wishes to retain the review period over the City Council act that authorizes a bond issue, what effect do you think the review period would have on this issue?

Mr. DIKEMAN. Mr. Chairman, in other words, you mean not have the provision in the bill which exempts the bond act of the Council from 602(c)? It would simply slow down the authorization process and mean that you have another——

Senator MATHIAS. You would have to wait another 30 days before you can go forward?

Mr. DIKEMAN. Yes. That's the only effect. It would have no adverse market effect because the act would either take effect or it wouldn't. It would be simply an additional delay.

May I skip back to the previous question just a second? I think some allusion has been made to investment grade rating, and for the record I think probably we ought to define that term. It is generally understood that an investment-grade rating is either triple B or B double A, or better, depending on which rating agency is involved. Anything below that is regarded as a noninvestment-grade rating.

Senator MATHIAS. The Home Rule Act imposes some debt service limitations which would be abrogated for the purpose of this legislation. Why do you think that is necessary?

Mr. DIKEMAN. Mr. Chairman, first of all, the so-called technical amendments legislation, which the District is proposing would generally amend the Home Rule Act to remove some ambiguities and supply some additional authority deemed necessary to generally give the District access to the market for its capital improvement bonds, contemplates a similar change in the charter specifically—the elimination of the so-called level debt service requirement. And I'll let Frank, as the financial adviser, speak as to why he feels that elimination is appropriate.

Mr. RAINES. Well, I just wanted to clarify in the question, were you referring to the total debt amount or the——

Mr. DIKEMAN. I think the chairman had reference, did you not, to level debt service?

Senator MATHIAS. Yes.

Mr. RAINES. Well, with regard to level debt service—similar to my answer to your question on the 5-year and 20-year bond—at any time there may be more desire in the market for a 15-year maturity, a 20-year maturity, an 8-year maturity, depending on who the purchasers are. It is highly desirable for an issuer to be able to bunch together maturities in any one particular issue to get the most favorable interest rate. A level debt service requirement has the effect of forcing you to have certain maturities in certain years, even where there are no buyers, or where there are few buyers. And so those few buyers can then push up the interest rate on you.

And so eliminating that level debt service requirement would give the District far greater flexibility, and it is a problem that we have with some other clients where we are also trying to find a way to get them some more flexibility to structure their bonds.

Mr. DIKEMAN. I think another very important point, Frank, should also be mentioned, namely that the level debt service requirement—aside from market considerations—seriously ties the District's hands in overall planning of its debt service payments. In other words, you can have a ballooning effect as time goes on, rather than being able to level total payments consistent with what the market requires in the way of maturities. So it does impede the District's ability to financially plan in an intelligent manner.

Incidentally, historically, I might note that the level debt service requirement and other similar provisions that one finds in the constitutions and laws of other States, were designed to prevent so-called ballooning of maturities whereby the forces in power at any

given time would issue bonds and postpone the evil day of repayment until they were sure that they would long since be gone. That was a laudable purpose and, as a matter of fact, was an actual practice which did exist back in the 1920's and early 1930's.

However, the greater sophistication of the market is such today that the market would not tolerate that type of practice and it is a somewhat antiquated provision.

Senator MATHIAS. Section 10 of the bill raises a question as to whether it contemplates the issuance of bonds above the $184 million figure.

Mr. DIKEMAN. No, Senator. Section 10 is the security provision. Perhaps the confusion may arise from the fact that section 10 applies to both the $184 million bonds authorized by this act as well as bonds issued under the general provisions of the Home Rule Act.

Senator MATHIAS. So it does not extend, in your judgment, the authority to issue additional bonds?

Mr. DIKEMAN. Oh, no. I can assure you that quite clearly is not the case. It was designed to give the District the power, when issuing bonds the Home Rule Act provisions for capital improvements, within the debt limit, to additionally secure that type of bond as a double-barreled bond in the same manner as the bonds contemplated by this act.

Senator MATHIAS. I have two very brief legal questions. You referred to the fact that bankruptcy was unavailable to the District of Columbia.

Mr. DIKEMAN. That's correct.

Senator MATHIAS. Is that a deterrent to a potential investor?

Mr. DIKEMAN. No. It's a big plus. Investors do not like the applicability of the bankruptcy laws to municipal issuers.

Senator MATHIAS. If the District can't go bankrupt, what can it do if it defaults?

Mr. DIKEMAN. If it defaults—well, of course, bear in mind, Mr. Chairman——

Senator MATHIAS. We hope we are talking about a highly unlikely contingency.

Mr. DIKEMAN. The provisions of the Bankruptcy Act as they now apply to municipalities, and not to States, are permissive in nature in any event. A municipality, if it defaults in the payment of its debt cannot be forced into bankruptcy. It is a voluntary act. And in addition, it requires State consent. These two points are important: one, that State consent is essential, and two, that it is voluntary in any event insofar as a municipality is concerned.

Because the remedy of bankruptcy obviously impacts or could impact on the security of outstanding bonds, bondholders do not look with great favor upon chapter 9. They would prefer that the remedy of bankruptcy not be available and that an issuer of bonds not be able in any way to reduce its obligation by resort to bankruptcy or a composition of creditors.

The usual legal opinion issued by bond counsel with reference to municipal bonds, ex-State bonds, has in it an exception to the opinion that any pledge of revenues or other security device is legally enforceable. That exception is taken with reference to the possible application of bankruptcy laws both present and future.

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We would be able to avoid that exception in our opinion as to existing law. Of course, we would have to take such an exception as to future law.

Senator MATHIAS. Well, now, one more question in that same area. What is the effect of the pledge by the city of some specific revenue on the priority which is currently claimed by Treasury?

Mr. DIKEMAN. The Treasury at this point is simply a general creditor of the District. It has no preferred position as a secured creditor. I don't know that I would agree, as a matter of law, that at the present time, under existing law, if there was a general default by the District and there was a suit instituted by various creditors, that the Treasury would be entitled to a priority position.

Senator MATHIAS. You don't see a current priority for Treasury?

Mr. DIKEMAN. I question whether there is one, yes.

Senator MATHIAS. If there were a Treasury priority, a prior Treasury lien, which would be in some way advanced prior to the marketing of these bonds, what effect would that have on marketability?

Mr. DIKEMAN. It would have an adverse effect, Mr. Chairman, and I don't think would serve any useful purpose. Let me point out that, what I have said before, about the lack of having a preferred position, perhaps, is an academic statement, not a practical one, because quite obviously the Federal Government, as a practical matter, is in a preferred position in that it could recoup, at least in installments, any amounts due by a simple offsetting against the Federal payment or other Federal aid. In practical effect, the Federal Government is in a very secure position insofar as its standing as a creditor of the District is concerned. And I don't think that position would be measurably improved by giving a legal status as a preferred creditor.

On the negative side, any such provision of law would, in my judgment, have an adverse effect upon the marketability of the bonds.

Senator MATHIAS. Thank you very much, gentlemen. I appreciate your statements and your patience in responding. As I mentioned earlier, the subcommittee would like to receive a copy of the financial instrument that you plan to prepare for presentation to underwriters and prospective investors, when that instrument is available.

[The prepared statement of Mr. Raines follows:]

PREPARED STATEMENT OF FRANKLIN D. RAINES, LAZARD FRERES & CO.

Mr. Chairman and members of the committee, my name is Franklin Raines and I am a vice president with the investment banking firm of Lazard Freres & Co. A major part of Lazard's business is providing financial advice to major corporations, national governments, state and local governments. We have served as financial advisor to the District of Columbia since August of 1979.

I welcome this opportunity to testify before the committee on the financial condition of the District and proposed actions to solve the District's immediate problems and to put it on a firm base for the future.

We were retained by the District to assist in the issuance of municipal bonds to finance capital projects. As you know, the District currently does its capital borrowing from the U.S. Treasury at interest rates substantially above those generally available to issuers of tax exempt securities. In fiscal years 1979 and 1980 the District borrowed $165 million from the Treasury. The District estimates that this borrowing will cost it $87 million more in interest over the next 30 years than if municipal bonds were issued. District entry into the bond market would also help

the federal budget by eliminating the need for additional Treasury loans. Of course, in order to successfully sell its bonds the District would need to obtain an investment grade credit rating. We, therefore, at an early date began to work with District officials to better understand the District government's financial condition.

In May of 1980 we presented a report to the Mayor which contained our analysis of the financial condition of the District as reflected in a balance sheet audit prepared by Arthur Andersen & Co. for the period ending September 30, 1979. We reported that the District had serious financial problems. First, the District had committed to spend more money than it had received in revenue over many years, which resulted in an accumulated deficit of $284 million. A large part of this deficit was caused by budgeting on a cash rather than accrual basis, which tended to conceal the full extent of expenditure commitments. Another cause was the rather unpredictable nature of the Federal payment and other revenue shortfalls. By the end of 1980 the accumulated deficit had risen to $387 million.

Second, the District was encumbered with an unprecedented burden of unfunded pensions. At Home Rule, responsibility for pension benefits earned prior to 1975 was passed to the District without any funds to pay for them. Currently, that unfunded pension burden amounts to $2 billion or $3,100 for every person living in the District; twice the per capita burden of New York City and three times that of Los Angeles. Every day the unfunded liability grows. Finally, we advised the District that, based on our experience with state and local finance, the future financial health of the District depended on developing a plan to deal with these and other problems. At a minimum this plan had to provide for (1) truly balanced future budgets, (2) a predictable Federal payment, (3) a means to finance the accumulated deficit, and (4) a plan to provide for the unfunded pension liability.

Before the committee today is one element of the plan prepared by the District. S. 744 calls for financing the cash shortfall portion of the accumulated deficit by issuing general obligation bonds additionally secured by a first lien pledge of a District revenue. We have advised the District that if this legislation is enacted, and if the District has managed to balance its budget, we believe that such bonds ought to receive an investment grade rating which would permit their sale in the municipal bond market.

Let me first address the need for this legislation. The accumulated deficit has put a severe financial strain on the District. Without good cash management, and the availability of cash flow advances from the U.S. Treasury, the District would long ago have failed to meet its obligations as they came due. All deficits must be financed. In the case of the Federal government this is done through its access to the public debt markets. This type of borrowing permits the deficit to be financed over a long period of time. The District has not had this luxury. It has financed its deficit by reducing cash in the general fund virtually to zero and engaging in various forms of short-term borrowing, such as tripling accounts payable, delaying the payment of court judgments and periodic borrowing from the Treasury. This approach is unsatisfactory over more than a short period. The District must find a way to finance its accumulated deficit over a longer period of time and provide for its orderly repayment.

I have provided the committee with a set of charts illustrating the District's severe liquidity problem. I will be happy to go through the charts at the end of my testimony should you desire. That analysis indicates that at the end of the last fiscal year the District had a cumulative cash shortfall of $313 million and a minimum cash need of about $184 million. The cumulative cash shortfall equalled 17 percent of the 1980 budget and the minimum shortfall was 10 percent of the budget. Experts assert that a local government is in a financial crisis when a cash shortfall exceeds 5-10 percent of the budget.

We concur in the judgment of District officials that issuing bonds to finance part of the accumulated deficit is the most viable approach available to them. The amount required is simply too large to try any other approach. It will not be easy and we cannot guarantee a successful result. But, if successful, it will restore the cash solvency of the District government, eliminate the need for acrobatic cash juggling, and impose a discipline of principal and interest payments to insure that the deficit is in fact repaid from future budgets.

Our belief in the feasibility of a bond issue is grounded on two points. First, the District will be able, upon passage of this legislation, to insulate bondholders from its short-term financial problems by giving a legally effective pledge to meet its debt service payments before other obligations of the city. Second, the District has a strong economy and several revenue sources which it can pledge to the payment of the principal and interest. These two elements, taken together, provide reasonable assurance that the District will be able to meet its obligations to bondholders. One

cannot ignore the additional requirement for the District to live within its means and balance its budget.

The District's plan achieves three important results in the shortest period of time. First, it provides cash for the general fund in order to relieve the serious liquidity problem. Second, it irrevocably commits the District to repaying the accumulated deficit, rather than leaving the matter to the vagaries of the annual budget process. Third, the plan permits the speediest entry into the municipal bond market to finance the on-going capital program of the District. All of this would be achieved without federal involvement and with reliance on the District's revenues. Implementation of the plan will not be easy but we believe it deserves a chance to succeed.

The committee staff has asked that we comment on one aspect of the testimony of the Treasury Department which strongly endorsed the legislation before the committee. The department indicated a "minor concern" with one technical aspect of the District's plan. The Treasury has a policy of seeking parity with subsequent creditors when it has made loans. We believe that policy is inappropriate for the situation of the District of Columbia.

The Treasury capital loans to the District are secured as a general obligation of the District and have additional security due to the practice of paying debt service on these loans from the federal payment. Since the Treasury administers both the loans and the federal payment, if the Department feels that it might not be paid, it has the practical ability to pay itself—to set off the debt service owed against the much larger federal payment. In effect the Treasury has a prior position with regard to the federal payment.

S. 744 does not reduce the security of the Treasury. By improving the financial condition of the District the bill, in fact, will improve the value of the full faith and credit pledge. The bill merely permits the District to pledge a locally generated revenue to give purchasers of District bonds a prior position in that revenue—a position not dissimilar to that which Treasury has, as a practical matter, in the federal payment. If the District were required to extend the pledge to include the Treasury capital loans the amount of revenue securing each future bond would be seriously diminished, interest costs would be higher, and the Treasury would unfairly receive priority in two major revenues of the District. The automatic application of such a policy would also jeopardize future revenue bond issues for utility and other purposes.

The Treasury has promised to study this issue in an effort to resolve this concern. We believe that the relationship of the District to the Treasury in the administration of the capital loans and the federal payment is sufficiently unique, and so greatly adds to the security of the Treasury, that the result of their study should be to agree that their security is not weakened by S. 744.

I am happy to answer any questions you might have.

Senator MATHIAS. Our second panel is Mr. Bert T. Edwards, audit partner of Arthur Andersen & Co., and Mr. William Anderson, Director of the General Government Division of the General Accounting Office.

Gentlemen, I offer you the privilege and option of submitting your statements which will be reported as if read in full and summarizing them as briefly as you can. As an inducement to doing that, I would say that I am due at another meeting and may be called away to vote at that meeting.

TESTIMONY OF WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE; AND BERT T. EDWARDS, AUDIT PARTNER, ARTHUR ANDERSEN & CO.

Mr. ANDERSON. All right. I'll take you up on your offer, Mr. Chairman.

I am Bill Anderson, Director of the General Government Division with the General Accounting Office.

I'd like to state GAO's position on the significance of the deficit. First, I think GAO is in full agreement with those that say that there would be nothing better from the Federal standpoint than for

the District of Columbia to be able to go to the market to obtain the financing for its long-term capital needs that it now obtains from the Treasury.

I think our comments concerning the significance of the deficit relate to the impact of that deficit on the District's solvency. I think the point of what we had to say was directed at one of the primary justifications of this bond issue when the idea was originally proposed, the need to protect solvency which appeared in danger. In fact, I think that July of this year was supposed to be a danger date.

In any event, that hasn't transpired. It hasn't transpired for some of the reasons that we cited in our report on the subject. A lot of those deficit items did not in fact represent a claim on cash.

The District, in fact, does have access to the Treasury for short-term borrowings. I would hope that if, as the Reagan administration wants, such authority is taken away for fiscal year 1983, the District would be able to find some other source of short-term borrowing given the fact that the banks in the District are not, unfortunately, as large and strong as they are in a lot of other localities.

However, there is nothing wrong with short-term borrowing. It is typical for municipalities across the county to issue something called revenue anticipation notes to deal with short-term cash needs. It is rare that the flow of revenues are going to correspond precisely with the expenses that they are intended to cover. So I guess it does concern us a little bit that one of the intents of this issue is to take the District out of the short-term borrowing mode that it now has with Treasury. There is nothing wrong with that.

After a lot of consideration and thought and study, I really sit here uncertain as to what the Congress position ought to be on this issue. I guess I wonder whether this is the right time? Given the fact that we believe that ultimately it would serve both the District's and the Federal interest for the District to stop borrowing from Treasury, is this the right time? Could they, in fact, work out from under their current problem without undertaking a long-term debt to satisfy an operating defict.

The debt service itself and the provision of a so-called sinking fund to cover the remainder of the accumulated deficit, is going to require something on the order of $30 million or more annually. In addition, they are going to have to avoid future deficits. This means that there have to be some additional revenues.

The District is just about taxing up to the hilt right now. There is no doubt about it. The District citizen right now is the highest taxed individual in the entire metropolitan area.

Senator MATHIAS. The citizens who are here would not disagree with that.

Mr. ANDERSON. And the business sector is highly taxed as well. I think that in the event that—if there were any large gains available by refinancing the existing debt to the Federal Government, that might point to a decision of, yes, let's do it, because they can refinance a lot of that debt and save some interest costs.

Unfortunately, a lot of the debt that the Federal Government holds right now is at rates that beat anything the District could get, even with a fairly decent rating on the bond market.

So I guess from our standpoint it is a question of when—and I won't pretend to say when—they should be allowed to go to the market. We have some reservations about this particular issue, because philosophically, borrowing long to pay short gives us some lingering concern.

And I'll close with that, sir.

Senator MATHIAS. Mr. Edwards?

Mr. EDWARDS. I brought along some statements which you may want to distribute to the press and certainly I think it would be good, Senator, if you had one of these and you could follow along my comments and I will attempt to summarize my remarks in light of the time.

While that is being passed out, I will say that my name is Bert Edwards. I am a partner in the accounting firm of Arthur Andersen & Co., and I was responsible for the audit engagement of the District of Columbia in 1980 and in 1979.

The 1980 audit covered all the operations of the District of Columbia and was the first such audit in the District's history, as you know. It followed an initial audit in 1979 of the balance sheet which established opening balances for the 1980 year.

The audit of the District requires a very substantial effort on the part of the District's financial personnel, at agencies as well as at the central accounting and financial areas, and, incidentally, took over 100 personnel from our firm as well as our coaudit firm of Lucas Tucker & Co. So this is a very major undertaking. The District is a $2 billion-a-year enterprise and there are not many companies of that size based in the Middle Atlantic region.

One of the findings in the audit was——

Senator MATHIAS. I would interrupt you to say that this committee is not without some involvement in the audit.

Mr. EDWARDS. I certainly would acknowledge that for the record.

Senator MATHIAS. I particularly pay tribute to my predecessor as chairman, Senator Eagleton, for his concern and persistent interest in requiring that a fiscal management plan be adopted. I think that the subcommittee's insistence on that played a major role in making it possible for us to have this discussion today.

Mr. EDWARDS. I think there are few here in this room or elsewhere who would challenge that statement.

One of the findings in our audit was the severe pressure on the District's cash resources, which is called liquidity, as a result of the deficits sustained in the District's general fund, which predecessor witnesses described. And, of course, this problem is what is being addressed by the legislation embodied in S. 744.

On my statement there are several charts which I think might draw together some of the comments and questions, Senator, that you had earlier of the other witnesses. And I might turn to those briefly, for a moment.

[The charts referred to follow:]

DISTRICT OF COLUMBIA HIGHLIGHTS OF 1980 AUDIT

First full audit—unqualifed ("clean") auditors' opinion rendered;
Financial Statements Fairly Presented
Financial Statements Follow Format Required of States and Cities
Conforms to Generally Accepted Accounting Principles

All District operations included:
General Fund—Housing, Human Services, Transportation, Schools, Public Safety, Environmental Services, Finance and Revenue, and General Government
Enterprise Operations—Water and Sewer, Hospital, Starplex, and Convention Center
University, Capital Projects and Internal Service Activities
Pension and Trust Funds

DISTRICT OF COLUMBIA GENERAL FUND

[Dollars in millions]

	September 30	
	1980	1979
Deficit:		
General fund deficit for the year:		
Before pensions	$105	$99
Including pensions	261	288
Cumulative at yearend (excluding pensions)	388	284
Components of general fund accumulated deficit:		
Liabilities	527	494
Assets	(139)	(210)
Total	388	284
General fund liabilities:		
Interest	96	88
Vendors	116	77
Tax refunds	24	33
Salaries due employees	48	56
Vacation earned by employees	39	40
Taxes applicable to future	69	67
Medicaid providers	33	30
Other:		
Professional tax case	37	35
Unexpended grant receipts	13	16
Advance from Federal Government		20
Litigation provision	15	12
Other	37	20
Total	527	494
General fund assets:		
Cash	9	59
Receivables—Taxes	76	56
Services	9	17
Government	62	69
Inventories	8	9
Other, net	[1] (25)	
Total	139	210

[1] Borrowing by general fund from other District funds.

District of Columbia

	In millions
Estimated cash needs: Sept. 30, 1980 General fund deficit	$388
Less—items not requiring immediate cash payment:	
Interest	96
Accrued leave	39
Taxes collected in advance	69
Total	204
Projected borrowing	184

Mr. EDWARDS. With respect to the audit, it is important to note that this covered all areas of the District, the general fund as well as enterprise and properietary operations, and the pension and trust funds. With respect to the general fund, in 1980, before considering pension costs, the District sustained a deficit of $105 million, compared to a $99 million unaudited deficit in the prior year.

Including the pensions, the deficit was substantially bigger, of $261 million versus $288 million, and that difference is attributed to the problem of the District's pension cost on an actuarial basis being far greater than what is being paid currently to the beneficiaries and that is a problem which the District, as you know, has approached Congress to talk about.

The components of the general fund deficit of $288 million is simply the excess of the liabilities over the assets and that is at the bottom of that page. I think if you go to the next page, you will draw together the liquidity problem which the other witnesses have talked about.

On the second page, you will see a listing of various types of liabilities and various types of assets. During the course of 1980, the liabilities increased from $494 million to $527 million, while the assets reduced from $210 million to $139 million. When you look at the assets there is a modest amount of cash, actually almost an infinitesimal amount of cash for an organization the size of the District, and that cash, it should be noted, only occurred because the general fund borrowed from other funds of the city. So, had that interfund borrowing not occurred, the general fund would have had a deficit of $16 million in its cash.

Certainly, the page shows that the District's liquidity was about at the minimum. In terms of the assets, they were drawn way down and many of the liabilities, as has been noted by vendors that haven't been paid, are reasonably high at the end of September. So, the situation the District is facing, quite frankly, is that, in order to operate itself like an organization of its size should be able to, it has asked for the bonding authority which is the subject of the hearings.

I think the figures sort of speak for themselves. As you see the liabilities growing, the assets diminishing. This year the District projects—and I should say, while we are in the process of the 1981 audit, obviously, the fiscal year ends tomorrow so we haven't done that—but the District projects that it will hold basically its financial pattern roughly as in 1980, which will result, if you have a break-even year, then you will pretty much have that same situation. There will be some adjustment, of course, in the components, but you would have that same $388 million deficit.

So, in response to your earlier question, does the passing of the year change significantly, my response as an accountant would be that components would change but I think the bottom line, if the District sustains its balanced budget, which it is hoping, the bottom line is still roughly going to be the same.

I think with that, I would conclude my comments and respond to any questions that you might have.

Senator MATHIAS. Let me first ask Mr. Anderson, from the perspective of GAO, leaving aside the intangible benefits, the intangi-

ble desirability of ending the incestuous relationship between the District and the Treasury, do you anticipate that it will also save money, by going into the bond market?

Mr. ANDERSON. Oh, there is no doubt about that at all, sir. Apparently there is about a 2-point difference between municipals and comparable Treasury borrowings.

Senator MATHIAS. So that if this program can go forward, there will be a significant savings to the District?

Mr. ANDERSON. No doubt about it, sir.

Senator MATHIAS. Assuming that they can take advantage of that, assuming that the market assigns them that level of credibility, then they can take advantage of that 2-point break?

Mr. ANDERSON. Right, sir. There is one other factor obviously working these days. Some people say that if all-savers certificates siphon off, the maximum I have seen cited is $250 billion, it would create some real problems in the municipal market, if you are talking practically about what could happen in the next year.

Senator MATHIAS. In addition to disputing the method of arriving at immediate cash needs, GAO contests certain items included in the $184 million determination. If these items were removed, would that, as has been testified earlier, violate generally accepted accounting principles?

Mr. ANDERSON. There is some confusion in the way that GAO's analysis has been characterized, sir. Really, what we were trying to do has nothing to do with generally accepted accounting principles. What we were trying to identify is what part of those liabilities that were included in the calculation of the deficit truly represent a supplemental cash need that the District has to be concerned with, would have to cover over and above all other expenses that should be covered in the coming fiscal year. And on that basis, for example, we said that accounts payable had an ending balance at September 30, 1979, again at September 30, 1980, and would have one in 1982; therefore, in calculating the cash needs to cover accounts payable during any one fiscal year, you don't add in the sum of all the payables that will come due that year plus the opening balance at the beginning of the year. You recognize that there will be an ending balance at the end of the year.

This was all aimed at striking to the point of solvency. How necessary is this issue for solvency?

I haven't heard anybody take a firm position on that and I don't know either, sir, but if somebody told me that they had to go out to the market in order to maintain their very solvency, then I'd think a little differently about the desirability of going out for an issue.

Senator MATHIAS. Well, in effect, as I read the letter that you sent us in response to our request for your views on the legislation, what you are saying is that you would not hang your whole case on the 1980 audit, but that you would look at what the historic experience of the city had been, and seeing that the actual cash needs were based on a cash flow review of a number of years?

Mr. ANDERSON. That is correct, sir. Most importantly, prospectively, what it would look like down the road. I have a copy of a document here, a report prepared by the Comptroller for the City Administrator in June of this year. It is a cash flow analysis projecting through to the end of fiscal year 1981. I will just quote

one sentence. "There are sufficient cash revenues to finance the District." In other words, given the existence of the large deficit, the District of Columbia did not have any difficulty in meeting all of its liabilities, in meeting its cash needs for fiscal year 1981.

Senator MATHIAS. In 1980, Arthur Andersen was able to give the District an unqualified opinion with respect to the audit.

Mr. EDWARDS. That's right, Senator.

Senator MATHIAS. That was a notable achievement.

Mr. EDWARDS. I would agree with that observation.

Senator MATHIAS. And I would pay tribute to everybody who had anything to do with it. I feel that it was a substantial oversight on the part of the Congress that we didn't provide for that in the Home Rule Act. But we didn't, and we finally were able to accomplish it, even though somewhat late. But I think that everybody who played a part in it deserves great credit. I think that the public perhaps doesn't fully realize the liability that the first home rule administrations of the city labored under, the fact that they didn't have a takeover audit. In the private sector, we wouldn't transfer ownership of a McDonald's hamburger stand without a full audit.

We in effect changed the management of a great city with no consideration at all of the accounting problems involved.

So I am glad that we have been able to remedy that error of omission. But are you anticipating that when you close the books for 1981 tomorrow that you will also be able to give an unqualified audit?

Mr. EDWARDS. Our present plan and the work that we have done to date would indicate that, when the audit procedures are completed in January and the report is published, that would be the result. However, I hasten to point out that it is tough to project the outcome of any type of a review such as an audit so I certainly can't guarantee that would be the result, similar to bond counsel not guaranteeing in his opinion. He pointed out, there are always contingencies. But you know we always aim for an unqualified audit and the city, in the past—I think I should state for the record—when there have been areas where qualifications might arise for one reason or another, the city has taken the action to get that matter cured to the point where an audit was successful and I would anticipate that they would have that same attitude for purposes of closing the books this year and in the future.

Senator MATHIAS. Do you agree with the Counsel's view that the debt limitation in the Home Rule Act should be waived for purposes of this bond issue?

Mr. EDWARDS. I really think that is a matter dealing with salability of bonds and the impression on the marketplace and, as an independent accountant, I really don't think that is in the purview of our professional advice, to take a position one way or the other on an issue such as that.

Of course, we do check the fact that the city does operate within its charter requirements as part of the audit, but as to what those requirements should be, that's really a point for legislative and oversight bodies as opposed to an accountant.

Senator MATHIAS. For this record, I wonder if you would provide us with a short memorandum of exactly what is involved in giving

an unqualified opinion? I think it might be useful to have that in writing.

Mr. EDWARDS. Do you mean to submit that supplementally to the committee?

Senator MATHIAS. If you would.

Mr. EDWARDS. All right.

Senator MATHIAS. We'll keep the record open for that. Mr. Anderson, we also have several technical questions that I am going to submit to you in writing.

Mr. ANDERSON. Fine, sir.

[Mr. Anderson's prepared statement, with an attachment, and responses to written questions submitted by Senator Mathias follow. Supplemental information from Mr. Edwards also follows:]

PREPARED STATEMENT OF WILLIAM J. ANDERSON

Mr. Chairman and Members of the Subcommittee, we welcome the opportunity to meet with you today to present our views on the proposal in S. 744 to authorize the District of Columbia to sell general obligation bonds to pay certain liabilities outstanding at the end of fiscal year 1980. The liabilities at issue are included in the much publicized accumulated operating deficit based on the first full audit of District accounts reported by the District's independent auditors as of September 30, 1980.

Whether the District should be authorized to issue and sell general obligation bonds to pay for an operating deficit is a matter of congressional prerogative, and we make no recommendation in that regard. However, we have some observations that may help in the deliberations on whether the bond sale should be authorized and on the amount that should be sold if the Congress grants the authorization. We provided comments to the Committee Chairman by letter dated June 10, 1981, on specific provisions of the bill. We would like to submit a copy of that letter to be included in the record of this hearing.

General obligation bond sales have been used to finance operating deficits by some jurisdictions, but the far more common use of general obligation bonds is to finance capital projects with a useful life at least as long as the term of the obligation involved. The District estimates that debt service of about $400 million would be required to repay the $184 million in bonds which would be authorized by this legislation. A significant amount of operating revenue—estimated at $20 million a year—would have to be dedicated for a substantial future period—20 years. Of course, the relative significance of this obligation will decrease as inflation-driven revenues continue to rise.

The District's financial condition has been of interest to us for some time. In 1975 we were actively involved in the decision to forego an independent audit of District activities at that time in favor of putting scarce resources to work in developing a financial management system. Work progressed, and for the fiscal year ended September 30, 1979, the District's independent auditor rendered an unqualified opinion on the city's balance sheet, which highlighted the existence of a substantial accumulated general fund deficit. Fiscal year 1980 operations were subjected to a full-scale audit and an unqualified opinion was rendered on all of the District's financial statements, again highlighting the accumulated general fund deficit.

The amount of bonds which would be authorized by S. 744 is derived from a calculation of "net eligible liabilities" from the General Fund Balance Sheet in the District's Fiscal Year 1980 Annual Report. Net eligible liabilities is equivalent to the accumulated general fund deficit as of September 30, 1980, less the amounts of three current liabilities which are deleted because they do not represent immediate cash needs—accrued interest payable on long-term debt, accrued annual leave payable to District employees, and taxes collected which are applicable to the future.

Other necessary adjustments might be identified by a complete detailed analysis of the current assets and current liabilities that are considered in calculating the "net eligible liabilities" amount used to establish the maximum bond authorization. If the District plans to use the cash from the bonds to reduce its general fund deficit by the amount of liabilities to be paid immediately, other items similar to the three excluded by the bill should be eliminated from the cash requirements determination. In essence, Mr. Chairman, we are saying that asset and liability amounts

determined in accordance with generally accepted accounting principles are not intended to measure cash needs and should not be used without adjustment. The objective of such adjustments must be to minimize the amount of money borrowed "long" to pay "short."

Regardless of the amount of bonds that the District might be authorized to sell, it is obvious that the District must take steps to assure that its revenues and expenditures are balanced in future years. Budgeted expenditures should include amounts required to pay bond interest when due and to provide for bond retirement upon maturity. Given the District's dynamic fiscal situation and the continuing demands for more and improved services, balancing the District's budget is difficult, but this goal must be attained if the District is to avoid future financial difficulties that could again prompt it to seek extraordinary measures to meet its expenses.

Mr. Chairman, that concludes my statement. We would be happy to answer any questions you might have.

Attachment

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington D.C., June 10, 1981.

B-202915

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Committee on Governmental Affairs,
U.S. Senate.

DEAR MR. CHAIRMAN: Your March 31, 1981, letter requested our views on S. 744, a bill to authorize the District of Columbia to issue and sell general obligation bonds for the purpose of paying certain liabilities of the District, and for other purposes. You asked for any recommendations we might have concerning possible committee action.

Whether the District should be authorized to issue and sell general obligation bonds to pay current liabilities and thus finance part of the accumulated operating deficit is a matter of congressional prerogative, and we make no recommendations in that regard. However, we have some observations for consideration during your deliberations on this issue.

The District estimates that debt service totalling about $400 million would be required to repay the $184 million initially borrowed. A significant amount of operating revenue—an estimated $20 million a year—would have to be dedicated for a substantial future period—20 years. Decisions to commit a city to this type of financing are usually reserved for capital projects with a useful life at least as long as the term of the obligation involved.

Only a portion of the reported accumulated deficit as of September 30, 1980, constitutes a cash need. The proposed legislation recognizes three items that we previously identified as not constituting a cash need, namely; interest, accrued annual leave, and taxes, and eliminates these items from the $388 million accumulated deficit, to arrive at the $184 million amount which would be financed from bonds.

If the intent is to restrict the amount of the bonds authorized to the cash shortfall associated with the deficit, there are other current liabilities which are similar to the liabilities excluded by the proposed bill.

For example, the current liabilities include accrued payroll in the amount of $47.5 million. This is a recurring item which will always have a year-end balance, although the amount may vary from year to year. The amount outstanding at the end of a fiscal year could vary because of the differences in the number of days between the end of the last full pay period in the year and the end of the fiscal year. For financial analysis purposes, the fact is that, as a general proposition, the District will be meeting 26 payrolls a year—no more, no less. The amount of accrued payroll will also vary, all other things being equal, because of differences in year-end employment levels and average salaries and wages.

Another item impacting on the 1980 deficit may have been overstated, namely the reserve for grant disallowances. In discussing actions taken to avoid a $60 million deficit in fiscal year 1981 operations the District announced that a $2 million reserve for grant disallowances for fiscal year 1981 would not be needed and therefore the estimated 1981 deficit would be $2 million less. District Office of Controller personnel advised us that the $13 million reserve included in the fiscal year 1980 annual report was considered adequate to cover any grant disallowances through fiscal year 1981. Thus, it appears that the fiscal year 1980 deficit was overstated by about $2 million for grant disallowances.

If each of the items discussed above are eliminated from the determination of cash needs—$47.5 million and $2 million for accrued payroll and reserve for grant

disallowances, respectively—cash needs would be $49.5 million less than the $184 million in proposed bonding authority.

Even the adjusted amount of $134.5 million may very well misstate the amount of money that the District needs. For example, the accounts payable item is analogous to the payroll item in that there is certain to be such an item at the end of the year. What is important is what part of the accounts payable total represents past due items that should have been paid during the fiscal year.

In our view, even as adjusted, the September 30, 1980, deficit does not provide the best measure of the District's borrowing needs. A more direct way of arriving at that figure would be to require the District to prepare a cash flow statement covering fiscal years 1981 and 1982. We suggest these years rather than reexamining fiscal year 1980 data, because of the District's dynamic fiscal situation which appears to have deteriorated even further since September 30, 1980. In that statement, cash requirements would represent all items that will fall due and should be paid within those years. Any differences between available revenues and this amount would seem to represent the amount of additional funds required by the District to get well from the standpoint of being able to meet its obligations as they fall due.

In addition, provision could be made to strengthen the District's working capital position by providing authority for some additional borrowing beyond the baseline need. The District looks upon the bond sale as a means to improve the current asset/current liability ratio in the general fund. Bond sales in excess of cash needs resulting from the deficit would accomplish this objective. Obviously, however, the bond sale will not solve the overall deficit position of the District since it would merely trade short term liabilities for a long term liability.

It is obvious that once the District gets current it must take whatever steps are necessary to stay that way. It must assure that revenues and expenditures are balanced in future years. If this is not done, then it is possible that the District could once again find itself in the same situation as at present—unable to pay its obligations as they become due and facing once again the need for extraordinary measures to maintain solvency.

We have the following comments on the specific provisions of the proposed bill.

Section 3(b) would limit the principal amount of bonds to $184 million, plus costs incidental to the issuance of the bonds and to amounts needed to provide a debt service reserve fund. The Committee may wish to obtain an estimate from the District of the reasonable and necessary costs of issuance and of maintaining the debt service reserve fund, so that either a specific amount or a limit could be included in section 3(b) to provide assurance that the cost of any bond issue authorized would be limited to reasonable and necessary amounts.

Section 4(a) would allow the Council to adopt one or more acts authorizing issuance of all or any part of the aggregate principal amount of bonds, and would allow such act to take effect immediately and be exempt from the provisions of section 602(c) of the Home Rule Act, which provides for congressional review and approval of District legislation. Section 4(b) provides that any such act set forth a plan for financing the amount required annually for payment of maturing principal and interest on bonds and identifying the source of the funds to be used for the payment. Section 4(a) would remove from congressional oversight the repayment plan for the bond program set forth in any act adopted by the Council. However, it is not clear whether the exemption in section 4(a) also removes from congressional oversight the implementation of the components of the plan set forth in section 4(b)(1) through (3), such as increasing taxes or reducing expenditures. The Committee may wish to retain oversight by striking the last sentence from section 4(a).

Similarly, section 4(d) would exempt the bonds from provisions of Charter Amendment Numbered 1 entitled "Initiative and Referendum." Since District residents may be called upon to pay additional taxes or forgo services to provide funds to retire bonds authorized under this proposed legislation, the Committee may want to consider whether citizens should have an opportunity to vote approval or disapproval of the terms and conditions of any bonds issued under this legislation.

Section 5(a) requires the Mayor to publish once in at least one newspaper any act authorizing issuance of bonds and a notice of the enactment in a form specified in the proposed legislation. However, section 5(b) provides that failure to publish the notice or any error in any publication thereof will not impair the effectiveness of the act or the validity of bonds issued pursuant thereto. The Home Rule Act, in section 463 contains language substantially identical to the language in section 5(a) of the proposed legislation. The Home Rule Act contains no provision similar to section 5(b). Since the notice provided for in section 5(a), in effect, signals the start of the limitation period provided for in section 6, we are not sure of the effect on the limitation period should the provisions of section 5(b) remain in the bill and notice

is either omitted or improperly rendered. The Committee may wish to clarify this matter.

Section 8(a) would require that proceeds from the sale of bonds be deposited in a special account in a federally insured financial institution in the District. Section 8(a) provides that these proceeds can be expended only for the purpose for which the bonds were authorized, and that any funds not so expended shall be applied only to the payment of annual debt service on the bonds. Section 8(b) provides that moneys realized on any investment of the proceeds of bonds shall be used for the same purposes as section 8(a), as well as to pay for the expenses of maintaining the special account. The payment of debt service is itself a purpose for which the District is authorized to issue bonds under section 3(a)(4). Furthermore, it is not clear whether the payment authorized in section 3(a)(3) of costs incidental to the issuance of the bonds encompasses the payment authorized in section 8(b)(3) of expenses of maintaining the special account.

To eliminate redundancy and to provide additional clarity, the Committee may wish to amend section 3(a)(3) to specifically include the payment of expenses of maintaining the special account and then provide that the proceeds in section 8(a) and the moneys realized from investments in section 8(b) may be used only for the purposes stated in section 3(a). These changes also would ensure that there are funds available to pay the expenses of maintaining the special account in the event that at some point the moneys realized on investments are not sufficient to pay such expenses.

Section 8(b) raises an issue by referring to moneys realized on any investment of the proceeds of bonds The bill does not specify the type of investment the District may make. It is not clear whether section 8(b) is an authorization to use the proceeds for reasons not specified in section 8(a), namely, to make investments, or whether "moneys realized on any investment" refers to interest realized as a result of a deposit under section 8(a). It would be useful if the Committee specified what type of investments are authorized. It may be appropriate for the District to be authorized to invest the proceeds, but such investments should be limited to interest-bearing, guaranteed investments in order to ensure that such investments do not result in a loss.

Section 10(a) authorizes the Council to provide in its act authorizing the issuance of general obligation bonds a pledge of District revenues as additional security for the payment of the bonds. Section 10(a)(1) through (7) lists requirements which the Council may include in its act authorizing the bond issue. These requirements also may be included in the contract with bond holders.

These provisions provide some additional guarantees as to how the bonds will be handled and the bond holders protected. The Committee should consider whether the protection provided in subsection (a)(1) through (7) should be required, rather than permissive, in situations when District revenues are pledged as security and whether particular parts of the subsection should be applicable even when District revenues are not pledged as security.

Subsection (a)(5) contains a provision which causes us some concern. It provides, in part, that the Mayor may enter into agreements concerning "the doing of any act (including refraining from doing any act) which the District would have the right to do in the absence of such agreement." It is not clear whether this provision allows the Mayor to incorporate in the agreement acts authorized by other laws, but not specifically authorized in this legislation. We believe that subsection (a)(5) should be clarified to indicate whether the agreement is limited to acts which the District would have the right to do under this legislation.

Section 12 would exempt from congressional oversight and control amounts obligated or expended from bond proceeds, amounts approved, obligated or expended for payment of any bonds and the pledge, transfer or assignment of any District revenues to secure or otherwise to provide for the payment of any bonds. The Committee may wish to retain and exercise its oversight and control responsibilities with respect to these items and accordingly may wish to revise the proposed legislation by deleting or amending section 12. In this connection, it may help in your deliberations to point out that section 13 proposes to make bonds issued under the proposed legislation tax-exempt and authorizes investments in District bonds by certain regulated financial institutions in conformity with the general District bond authority contained in sections 485 and 486 of the Home Rule Act.

We would be pleased to discuss this matter further with you or your staff.

Sincerely yours,

MILTON J. SOCOLAR,
Acting Comptroller General
of the United States.

U.S. GENERAL ACCOUNTING OFFICE,
Washington, D.C., October 19, 1981.

B-202915

Hon. CHARLES McC. MATHIAS, Jr.,
Chairman, Subcommittee on Governmental Efficiency and the District of Columbia, Committee on Governmental Affairs, U.S. Senate.

DEAR MR. CHAIRMAN: Your October 7, 1981, letter transmitted a copy of the transcript of recent hearings before your subcommittee at which I had the privilege to testify. A corrected copy of the transcript is enclosed in accordance with your request.

The questions you submitted are answered below. For your convenience we have restated the questions.

1. If the City were to borrow based only on future cash needs as estimated by a cash flow review, how would the deficit revealed by the fiscal year 1980 report be retired?

Reply: The reported general fund deficit for fiscal year 1980 was $387.5 million. The District has announced plans to retire about $204 million of this deficit by setting aside $10 million a year because the items comprising the $204 million are not liabilities that require payment.

The District proposes to meet the remaining $184 million deficit through bond sales. If bond sales were limited to cash requirements estimated on the basis of a cash needs analysis, the required amount, in all likelihood, would be something less than the $134.5 million mentioned on page 2 of our June 10, 1981, reply to Chairman Roth's request for comments on the bill. Whatever the amount borrowed, the feneral fund deficit would be reduced by an identical amount. The remaining deficit amount could be reduced by increasing the $10 million set aside by whatever amount the District can afford. In this connection the District should be able to afford to pay the difference between the estimated debt service on the $184 million which would be authorized by the bill and the debt service on the amount borrowed to meet cash needs as determined by a cash needs analysis.

2. Can you assess the ability of the City to issue bonds for a substantially shorter period of time than has been discussed so far—perhaps 5 years?

Reply: We are not in a position to speak specifically to the City's ability to issue and repay bonds over a substantially shorter period than the 20 to 30 years generally discussed to date. Obviously, annual debt service on a bond issue for a 5-year period would be substantially higher than would be the case for longer term bonds, although total debt service would be lower over the short term. This would generate a severe impact on the City budget. Further, the District's ability to generate the required increased revenues to meet the increased debt service is a real question. We have no empirical data to make a judgment here, but we have serious doubts that the District can consistently generate surpluses to meet the increased debt service on 5-year borrowing of $184 million, or even $134 million. Further, the increased annual debt service required to retire obligations over the shorter term might reduce funds available to satisfy the $10 million annual set aside.

3. Senate bill 744 would exempt the proposed bonds from certain requirements of the Home Rule Act. Would you please comment on the advisability of such exemptions?

Specifically: (a) The City Council Act authorizing the sale of bonds would not be subject to the congressional review period.

(b) The bill would exempt the issuance of the bonds and the debt service from the debt limit contained in the Home Rule Act.

(c) The bill would exempt the bond issue from the referendum and initiative provisions of the Home Rule Act.

Reply: 3(a) As we read the pertinent sections of S. 744 and the Home Rule Act, section 4(a) of the proposed legislation would effectively remove bond transactions from the Home Rule Act. These provisions are found in the congressional review and approval provisions of the Home Rule Act. These provisions are found in Title VI of the Act, under the caption "Reservation of Constitutional Authority," and seem to provide the Congress with the means to carry out its constitutionally mandated oversight responsibility. We see no reason to suspend these provisions for what is touted as a one-time effort on the part of the City, and on page 4 of our June 10, 1981, response we suggest that the Committee might wish to retain oversight by striking the late sentence from section 4(a) of the bill.

3(b) Many localities have maximums on debt service to insure against overextending a city's ability to retire its obligations in an orderly fashion. Given the District's financial condition it would seem prudent to utilize available control mechanisms to protect against overextension of the District's debt paying ability. Further, we see

no reason to differentiate between general obligation bonds sold under the proposed legislation and bonds sold or other indebtedness incurred in capital programs; both types of obligations should be subject to the limitation. However, we understand that the 14 percent limit may be low in relation to today's market; you may wish to consider whether the limit should be increased.

3(c) Since District residents may be called upon to pay additional taxes or forego services to provide funds to retire bonds authorized by the proposed legislation, it seems that district residents should have an opportunity to vote approval or disapproval of the terms and conditions of any bonds issued under this legislation.

We would be pleased to discuss these matters further with you or your staff.

Sincerely yours,

WILLIAM J. ANDERSON, *Director.*

ARTHUR ANDERSEN & Co.,
Washington, D.C., October 17, 1981.

Hon. CHARLES MCC. MATHIAS, Jr.,
Chairman, Subcommittee on Governmental Efficiency and the District of Columbia, Committee on Governmental Affairs, U.S. Senate, Washington, D.C.

DEAR SEN. MATHIAS: At the hearings on September 29, 1981, on S. 774, you asked that I provide you with a letter of what is meant by the term, "generally accepted auditing standards."

The American Institute of Certified Public Accountants in its "Codification of Statements on Auditing Standards," summarized generally accepted auditing standards as follows: (Section AU 150.02).

"GENERAL STANDARDS

"1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

"2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.

"3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

"STANDARDS OF FIELD WORK

"1. The work is to be adequately planned and assistants, if any, are to be properly supervised.

"2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

"3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

"STANDARDS OF REPORTING

"1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.

"2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

"3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

"4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking."

The foregoing is the general foundation upon which all generally accepted auditing standards are based. The AICPA, from time to time, will issue new or revised standards or interpret outstanding standards as the needs of the profession require. Thus, in a sense, generally accepted auditing standards includes a substantial volume of official pronouncements as well as additional standards which, while not embodied in an official pronouncement, have become generally accepted through common usage.

With respect to governmental units, AICPA has issued a special publication, Audits of State and Local Governmental Units. Because this publication would appear to be particularily applicable to your interests, I am enclosing a copy of it with this letter for your information.

I would be happy to answer any questions you may have concerning this letter.

Very truly yours,

BERT T. EDWARDS.

Senator MATHIAS. Now we will hear from a panel of residents of the District whom we are delighted to have with us today. Mr. John Woodson, representing the D.C. Federation of Civic Associations, Mr. John J. Phelan of the Capitol Hill Restoration Society, and Mr. Joel H. Garner of the Advisory Neighborhood Commission.

Gentlemen, I again offer you the option of submitting your statements, which will be printed in full as if read. I have to advise you that my coach turns into a pumpkin precisely at noon. So you can divide up the time in any way you want, but we will have to adjourn at noon.

TESTIMONY OF JOHN S. WOODSON, D.C. FEDERATION OF CIVIC ASSOCIATIONS, INC.; JOHN J. PHELAN, CAPITOL HILL RESTORATION SOCIETY; AND JOEL H. GARNER, ADVISORY NEIGHBORHOOD COMMISSION 3D

Mr. WOODSON. Thank you, Mr. Chairman.

I am John Woodson of the D.C. Federation of Civic Associations. And we wish to thank you at this time for the opportunity to testify on Senate bill 744 and regard this as the first time in the history of the D.C. government's attempt to float bonds, in a public hearing, that the citizens have had a chance to speak.

Senator MATHIAS. The people that are going to pay for the bonds.

Mr. WOODSON. And to be heard. That's correct, sir.

I would like to have my statement included in the record, as you have suggested.

Senator MATHIAS. We will be happy to do so.

Mr. WOODSON. The D.C. Federation of Civic Associations has gone on record as being opposed to the Mayor's effort to gain long-term bonds. As I have listened to the technical experts here today, the thing that has gone across my mind is, one, do they live here, and are they going to have to participate in spending $500 million to borrow $184 million, which I don't think is wise. And second, the tenuous situation of the budget, in which they talk about $184 million, does not take into account a lot of things.

We've got Union Station down the street here, which the Federal Government may or may not turn over to the District government on any given day. They do turn over Federal properties to the District, and that would wipe out a great portion of this manipulation of the budget just in one fell swoop.

Our District government budget does not take into account debts which we presently owe, the Stadium Armory, which there is debate about, and the increasing cost of Metro and all these other things which change, which cause change.

So we are talking about $184 million and it seems to me, really, the big problem is, can the D.C. government control its spending, and I don't think it can, and will it be able to in the future? I'm not too sure that that's possible.

Now, when we talk about Cleveland and New York, St. Louis, the attempts to rid them of their financial problems were very closely tied to severe regulations which restrict that government in the way it runs.

Now, I don't think the U.S. Congress, in view of the home rule bill and the effort to get home rule in the District of Columbia government is going to attach to this bond issue the kinds of stipulations which are going to require that the District government be strapped down because then we wouldn't have home rule. So I think that the best means of assuring that the District operate in a financially secure and a financially responsible manner is to deny the District government the freedom to overspend by denying them the ability to borrow on a long-term basis.

Thank you.

Senator MATHIAS. Thank you, very much.

Mr. Phelan?

Mr. PHELAN. Mr. Chairman, my name is John Phelan. I am representing the Capitol Hill Restoration Society, a civic group located here in the Capitol Hill community.

I've submitted some testimony and I will try to just skip over it to make it brief.

Senator MATHIAS. Your entire statement will be made a part of the record.

Mr. PHELAN. We feel the issue before the Congress is whether or not the District should be permitted to issue long-term bonds, not for a capital project but to refinance deficits in the current operating budget.

As citizens of the District of Columbia, we are in full agreement with the idea that we should be able to govern our own financial affairs. However, we believe that S. 744 does not provide the proper safeguards afforded citizens of most States with regard to bond offerings by their elected officials.

The Congress should take this opportunity to grant additional voting rights to District residents concerning financial policy that will have a significant impact on present and future generations of taxpayers.

We believe the issuance of 30-year bonds to pay off operating deficits, as this bill would permit, clearly is such a policy calling for citizens' approval.

It has been mentioned before, today, that the 30-year cost of this bond issue will approach $600 million to $700 million depending on the interest rate. Currently, municipals are selling at, yielding at about 13 percent.

We believe this is a very serious cost and we are also concerned about the exemption of the debt ceiling provision of the bill.

We are particularly concerned about the longrun issues and whether or not a future Mayor and future City Councils and future taxpayers should be required to pay off the deficits which most people agree, has occurred in the last 2 to 3 years.

If we were to add to the expected capital project estimates for capital spending for the next 4 or 5 years, the cost of the $184 million bond issue, by 1985, I have estimated that the city's debt service will be about $265 million a year. That is double what the debt service is today and will put a serious constraint on spending

by the District government for social programs and other necessary projects.

We believe, Mr. Chairman, that there should be a full public debate on the District's financial condition before these bonds are issued. We believe the residents of the District deserve to know how the deficits came about, especially since our taxes have been contributing substantial new sources of revenue to the District.

We would like to know why the city cannot sell certain valuable property in the downtown area in order to meet this deficit. We would like to know why the District's Redevelopment Land Agency is selling valuable property in our downtown to politically well-connected individuals for millions of dollars less than the market value. I would just mention Metro Center and the Gallery Place parcels that were recently sold for way below market value.

Additional questions about the deficit and how it should be handled were raised by Mr. Watson in testimony before the House and I believe this committee is well aware of Mr. Watson's concerns. He, basically, believes that the city ought to pay off the $184 million, or whatever the number is, within the next 5 to 7 years, out of current growth and revenues for the District, rather than issue long-term bonds that will cost substantial amounts in interest.

Mr. Watson has pointed out, and few people realize, that the District is experiencing a substantial growth in locally raised tax revenues. Last year it was $170 million, approximately a 20-percent growth in locally raised taxes. Most cities are having problems with revenue estimates and the revenue side. The District, apparently, is having problems with the spending side of the budget and we have very serious concerns about that.

So we have proposed that the bill be amended, and we would support the bill if it were so amended, that the city be permitted to issue bonds, but any bonds with a maturity in excess of 5 years be subject to a referendum by the city voters.

I believe this amendment would accomplish a number of things that are of concern to the city. The District would be permitted to issue notes and borrow from the U.S. Treasury under current authority in order to meet any cash shortages until a bond referendum could be held. Two, it would permit the District to issue short-term bonds or notes in the event the voters do not approve of the long-term borrowing in the referendum. And, three, it would permit the District government the opportunity to withdraw a long-term bond offering from the market, assuming such an issue had been approved by the voters, if market conditions should deteriorate.

If at the time of the issue, bond market conditions do not permit the sale of the bonds at a reasonable yield, that is apparently what is going on right now, we feel that this is especially important if the District does not receive an investment grade bond rating.

We believe the amendment proposed is necessary and consistent with sound principles of municipal finance. It gives the Congress the opportunity to extend voting rights for District residents, especially since S. 744 will amend the Home Rule Act, and at the same time shift the responsibility of solving the city's financial problem to the people of the District of Columbia.

Thank you.

Senator MATHIAS. Mr. Garner?

Mr. GARNER. Thank you, Mr. Chairman.

My name is Joel Garner and I am here representing Advisory Neighborhood Commission 3D, one of the 36 advisory neighborhood commissions established by the Congress and the District government.

Senator MATHIAS. Which have my enthusiastic support.

Mr. GARNER. Yes, we appreciate that, sir.

I have submitted some testimony for the record.

Senator MATHIAS. We will be pleased to include your statement in the record of this hearing.

Mr. GARNER. What we would appreciate today, and I will summarize my position, is very simple. This bill is anti-home rule. It is a major charter amendment which has not been submitted to the Council of the District of Columbia and has not been ratified by the voters of the District of Columbia. Unlike other opponents of the statehood initiative, the gambling initiative, and the sexual practices legislation, our opposition is based on the fact that we have not had a chance, either in the City Council or by the voters, to consider and approve or reject this legislation. That is a bad practice and it is a bad precedent.

Worse, this legislation, in section 4(d), takes away from the Council the authority to have a referendum on the bond authorizing legislation that the Council will need to pass to implement this charter amendment.

This legislation not only amends the Home Rule Charter without voter approval, but takes away the authority of the Council to hold a referendum on the implementing legislation. We think that is very bad, it is bad for the District of Columbia, and it is bad for home rule. And it is bad for the Congress of the United States.

Again, opposition to this bill is a vote in favor of home rule and we'd appreciate your consideration. The positions that Mr. Phelan stated, that some sort of requirement in this legislation, for approval by the voters—the people who are going to have to pay for this—is mandatory, and that could be acceptable. His considerations about short-term financing would be acceptable. But 20- and 30-year bonds without any approval by the District of Columbia residents is totally unacceptable.

Thank you.

Senator MATHIAS. Thank you, very much.

Your statement leads me to a question which I propound on behalf of Senator Eagleton, as well as myself. If this bill were to be amended to provide for a referendum on the sale of general obligation bonds, as you suggest, how long do you think that process would take?

Mr. GARNER. Had the Mayor submitted this legislation to the Council when he submitted it to the Congress, we could have had a referendum this November. I don't know how long it would take now. The gentleman from today spoke in terms of February 1982 when they were planning on issuing the bonds. I don't believe a referendum would be possible by that time. I am not sure. Jack, you are more familiar with the referendum process.

There is something like a 3-month delay from when the Council passes legislation and when a special election could be provided for. I think it is very important and the cost of the election would be very minimal compared to the cost of this bill and the importance of the home rule principle.

Mr. PHELAN. In that regard, a question was asked of a member of the city administration at a public forum held by the League of Women Voters in the District as to why this issue was not put up to referendum and his only comment was that it would lose.

Senator MATHIAS. It would what?

Mr. PHELAN. It would lose if it went to the voters. And I don't think, Mr. Chairman, that is an excuse to bypass the Home Rule Charter.

Senator MATHIAS. Do any of you have any feeling about whether a referendum on bonding authority be mandatory or whether it should be subject to City Council discretion as the Home Rule Act provides?

Mr. PHELAN. It is my own personal preference that the Council pass a charter amendment and send it to the Council permitting or requiring a bond referendum on all future long-term borrowing so that we don't get into this type of situation. A bill has been introduced by Council Member Betty Ann Kane that would have the effect, if approved by the Council, and then placed on the ballot, requiring referendum on future bond issues.

I would prefer to see that method be adopted rather than having to come to the Hill and ask that our charter be amended.

But I do think that a bond referendum should occur one way or the other.

Mr. GARNER. I believe in Mr. Phelan's testimony there is information indicating the number of States and local communities which require referendums on capital bond issues. It is a fairly common practice and is considered fiscally responsible. And we would like to be considered fiscally responsible in the District of Columbia.

Senator MATHIAS. Well, that is the ambition of this subcommittee.

When that happy state is reached we will consider that we have done something useful for a change.

Gentlemen, we thank you very much for your presence here today. I think the voice of the citizens is an important component in this legislation and you have provided that voice. We appreciate very much your attendance here today.

Additionally, without objection, the statement of Hon. Arrington L. Dixon, Chairman of the Council of the District of Columbia, will be included in the record of this hearing.

[The prepared statements of Messrs. Woodson, Phelan, and Garner follow:]

PREPARED STATEMENT OF JOHN S. WOODSON, SPEAKING FOR THE D.C. FEDERATION OF CIVIC ASSOCIATIONS, INC.

The District of Columbia Government should not be allowed to enter the bond market to sell either long or short term bonds. The Federation of Civic Associations in delegate assembly has gone on record in opposition to such borrowing without voter approval in relation to the Mayor's 1981 bond bill.

The real problem in the District of Columbia's failure to operate in the black as mandated by the U.S. Congress is that for the past 10 years the Congress did not insist the applicable laws and regulations be obeyed. The city government has little control over the spending that occurs by city agencies and constantly asks the Federal Government for supplements. In the past decade the overspending has amounted to about $400 million. Now that congressional supplements will be few, and Treasury loans will become rare, this attempt is being made to have the debt pushed back to the maturity date of bonds which will place an impossible burden on the city 30 years from now. We believe the best procedure is to adhere to the approved budgets and to control spending.

The history of mayoral government is that the D.C. citizens are paid little attention to at Council hearings and that referendum issues are allowed to go to the polls only when the Mayoral-Council coalition wishes the taxpayer to have say on specific matters. For example gambling yes, convention center, no. And to cap it all look at the foolishness of spending $500 million to borrow $184 million. That is worse than our banks used to do to the banana republics.

PREPARED STATEMENT OF JOHN J. PHELAN, REPRESENTING THE CAPITOL HILL RESTORATION SOCIETY

The issue before the Congress is whether or not the District of Columbia should be permitted to issue long-term bonds, not for the construction of some capital project, but to refinance deficits in the current operating budget. As citizens of the District of Columbia, we are in full agreement with the idea that we should be able to govern our own financial affairs. However, we believe that S. 744 does not provide for the proper safeguards afforded the citizenry of most states with regard to public bond offerings by their elected officials. The Congress should take this opportunity to grant additional voting rights to District residents concerning financial policies that will have a significant impact on present and future generations of taxpayers. We believe the issuance of thirty-year bonds to pay for operating deficits, such as S. 744 would permit, clearly is such a policy calling for citizen approval.

As I am sure you are well aware, the idea of using long-term borrowing to pay for operating deficits is particularly without precedent in the history of the United States. S. 744 would permit our elected officials to float a $184 million bond issue at a total cost to District taxpayers of approximately $600 to $700 million. In addition, S. 744 would exempt the bond issue from the debt ceiling provisions of the Home Rule Act. Unlike the federal refinancing of the New York City deficit, S. 744 does not provide for financial constraints on the part of the city administration to insure that deficits do not reoccur in this or future years. It is becoming increasingly clear that most of the liabilities the District plans to eliminate with the proceeds of this bond issue are the result of overspending within the past 2 or 3 years. This being the case, it raises serious questions in our minds concerning who should be held responsible for the problem—future mayors, city councils and taxpayers or the present city administration? The answer to this question has direct policy implications about the use of long-term vs. short-term debt. Short term borrowing would require that current elected city officials solve the overspending problems. The effect of S. 744 is to shift the burden to some future administration by causing a substantial increase in our outstanding debt and increasing our already large yearly debt service payment. In order to fully comprehend the financial impact that S. 744 will have on the future of the District it is necessary to understand the city's outstanding debt structure.

In addition to the problems of overspending in the areas of welfare and medicaid, interest on our outstanding debt is resulting in serious budgetary difficulties. For example, interest and principal payments on our capital outlays for fiscal year 1982 will be $145 million, up 18 percent over the fiscal year 1980 figure. Our already substantial outstanding indebtedness appears to be growing faster than anyone anticipated. In 1977, the District's 5-year capital improvements program projected that capital appropriations for fiscal year 1981 would be $47 million. Actual appropriations for fiscal year 1981 turned out to be $188 million. The fiscal year 1982 budget request now before the Congress includes $200 million for capital projects, up almost 400 percent from the projected fiscal year 1982 level made just four years ago. The General Accounting Office has estimated that the District's total outstanding debt will be $2,747,000,000, by 1985, or approximately $4,360 per capita, up from $2,744, per capita in 1980. To make matters worse, we believe that the GAO forecasts are probably biased downward since they were made over two years ago. All this means that the District is likely to have the highest debt per capita of any city in the country.

In addition to the increasing size and cost of our capital projects budget, inflation has increased the cost of borrowing for these projects as well. The current long-term U.S. Treasury rate is approximately 13 percent. It is probably safe to assume that the District's bonds will receive a "b" rating and that the yield on this bond issue will be approximately 13 percent. The District plans to borrow approximately $1 billion over the next 5 years for capital projects (including the $184 million in bonds that S. 744 would authorize). The 30-year cost of borrowing this amount at 8½ percent would have been approximately $2.77 billion. At a rate of interest of 13 percent, the total cost balloons to $4 billion. The annual debt service on this amount will approach $132 million. This must be added to the annual debt service on our current outstanding debt of $1.7 billion which is averaging about $133 million. Thus, our total annual debt service costs by the end of fiscal year 1985 will approach $265 million if interest rates remain at or near 13 percent for the next few years. The General Accounting Office (GAO) estimated that the debt ceiling for the District will be $240 million by fiscal year 1985. Thus, one of the effects of S. 744 would be to allow the District to exceed the debt ceiling limitations on long-term borrowing called for in the Home Rule Act.

Mr. Chairman, we believe there should be a full public debate on the District's financial condition before these bonds are issued. I believe the residents of the District deserve to know how the deficit came about even though our taxes have been contributing substantial new sources of revenue to the District government? We would like to know why the city cannot sell certain valuable property in the downtown in order to meet this deficit. I would like to know why the District's Redevelopment Land Agency (RLA) is selling very valuable property in our downtown to private developers for millions of dollars less than its market value?

Additional questions were raised at the hearings on H.R. 1807 held by the House District Committee which should be explored before bonds are offered. For example, Mr. Matthew Watson, the former District of Columbia Auditor, claims that it would be better for the District's bond rating if the $184 million in operating deficits were paid off from current revenues over a period of 5 to 7 years at about the same yearly cost as the debt service would be if we borrowed the $184 million for 30-years. Thus, our bond rating would improve and we would save millions of dollars in debt service payments at the same time. The deficit could be repaid from the substantial growth in locally raised tax revenues. Mr. Watson pointed out that the District experienced an increase in tax collections last year of $170 million, or about 20 percent. While most cities are experiencing a decline in tax revenues we are very fortunate in this regard. While most cities have revenue problems we have spending problems. In addition to the issues raised by Mr. Watson, the General Accounting Office testified that the District does not have a "cash" deficit of $184 million but more likely it is only $137 million. In any event, a number of problems and issues remain unsettled. We believe these questions will not be answered unless S. 744 is amended to require a referendum.

In keeping with normal municipal financing standards, we do not believe that decisions to borrow short-term funds, either from the U.S. Treasury or by issuing short-term bonds should require the approval of the taxpayers of the District in a bond referendum. The elected officials responsible for this borrowing will be required to insure that funds are provided for the retirement of this debt. Therefore, we recommend that S. 744 be amended to require voter approval for all bond offerings or U.S. Treasury borrowings that will have a maturity period in excess of 5 years. This amendment will accomplish the following: (1) The District government will be permitted to issue notes, or borrow from the U.S. Treasury under current authority, immediately in order to meet cash shortages until a bond referendum can be held this coming November; (2) permit the District to issue short-term bonds or notes in the event District voters do not approve longterm borrowing in the referendum; and (3) permit the District government the opportunity to withdraw a long-term bond offering from the market, assuming such an issue has been approved by the voters, if bond market conditions do not permit the sale of such bonds at a reasonable rate of interest. This option could become especially important if the District does not receive a favorable bond rating.

We believe the amendment proposed is necessary and consistent with sound principles of municipal finance. It gives Congress the opportunity to expand voting rights for the District, especially since S. 744 will amend the Home Rule Act, and at the same time shift the responsibility of solving the city's financial problems to the people of the District of Columbia. Thank you.

PREPARED STATEMENT OF JOEL H. GARNER, REPRESENTING ADVISORY NEIGHBORHOOD COMMISSION 3D

I appear before this subcommittee to oppose The District of Columbia Bond Authorization Act. This legislation's deficiencies are many but none so glaring as its frontal assault on Home Rule for the District of Columbia. This legislation destroys the fundamental principle of Home Rule; the right of the Council to propose and the voters to approve substantive amendments to the District of Columbia Self-Government and Governmental Reorganization Act.

Of all the issues before the committee, none is more crucial than the preservation of the fragile Home Rule given to the residents of the District. A vote in opposition to this bill is a vote in favor of home rule. Thus, unlike recent efforts by opponents of the Statehood Initiative, the Gambling Initiative, and the legislation regarding sexual practices, our opposition is based in great part on the fact that the legislation before you today has never been considered or approved by the voters of the District of Columbia or their elected representatives. The Mayor, it is true, personally supports this bill, but neither the Congress, in its wisdom, nor the voters, in theirs, have given the Mayor the unilateral authority to amend the Home Rule Charter.

The Home Rule Act is very explicit. It provides for two mechanisms which can be used to amend the Charter. The primary method is for the Council and the Mayor of the District of Columbia to propose a Charter Amendment, which if approved by a public referendum, would be submitted to the Congress for the 30 day review period which now applies to all D.C. legislation. Since 1973, this mechanism has been used only once and resulted in the inclusion of the Initiative, Referendum, and Recall provisions in the charter. The second mechanism provided in the Home Rule Act is for unilateral amendment of the Charter by the Congress and the President. Such amendments have occurred since 1973 but only on highly technical issues. Certainly, no one who supports the principles of home rule could believe that such a major public policy queston as the issuance of long term bonds to finance operating deficits should be approved by the Congress unilaterally. On behalf of ANC 3D and the other civic organizations who have petitioned you, I urge you not to take from us such a basic voting right as the approval of amendments to our Home Rule Charter.

What we ask of you is not special or exceptional. Every State in the Union except Delaware requires a public referendum to amend their constitution. The Home Rule Act is our constitution and the Congress required a public referendum by the voters of the District of Columbia before it was adopted in 1974. We ask you to give us no more than what you approved in 1973, what D.C. voters approved in 1974, and what 49 of 50 State constitutions require.

Now it can be argued that certain special circumstances exist which make these normal procedures inappropriate or unnecessary. Proponents of the Bond Authorization Act feel that a "speedy" approval is needed so that the District can quickly enter the bond market and set its finances straight. I will let the experts speak to the favorable conditions currently prevailing on the bond market and limit my concerns to the need for quick approval. Very simply, no such expedited approval justifies circumventing the Home Rule Act. Had the Mayor submitted his Charter Amendment to the Council at the time he submitted it to the Congress, there would have been plenty of time for Council consideration and a referendum on this Charter Amendment. We submit that there is still plenty of time for such normal consideration even though the opportunity for a referendum this Fall is oviously lost. It is the proponents' legislative tactics, however, not the substance of this bill which provides any urgency to its consideration by the Congress.

It can also be argued that while a public referendum on this Charter Amendment would be nice, it is unnecessary since the Charter permits the Council to provide for a public referendum on the bond authorization legislation they must pass to implement this Charter Amendment. I will not address the legal merits of such an argument but I will admit its political appeal. Unfortunately, the D.C. Bond Authorization Act specifically prohibits such a vote. Section 4(d) removes from the Council the authority to hold a referendum on the bond authorization legislation. It is perfectly clear that the authors of this legislation want the Congress to not only unilaterally amend our Charter, but also remove from the Council and D.C. voters, the right to approve or reject this proposal.

This legislation is bad for the District of Columbia, bad for Home Rule, and bad for the Congress of the United States. We urge you not to kill Home Rule by approving this bill.

Senator MATHIAS. The subcommittee is now adjourned.

[Whereupon, the subcommittee was adjourned at 12:02 p.m., subject to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

97TH CONGRESS
1ST SESSION

S. 744

To authorize the District of Columbia to issue and sell general obligation bonds for the purpose of paying certain liabilities of the District, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 19 (legislative day, FEBRUARY 16), 1981

Mr. MATHIAS (by request) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

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A BILL

To authorize the District of Columbia to issue and sell general obligation bonds for the purpose of paying certain liabilities of the District, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "District of Columbia Bond Authorization Act of 1981".

DEFINITIONS

SEC. 2. For purposes of this Act:

(a) The term "bonds", except when reference is made to bonds authorized pursuant to the Home Rule Act, means the

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general obligation bonds of the District authorized to be issued pursuant to section 3 of this Act.

(b) The term "Council" means the Council of the District of Columbia provided for by section 401 of the Home Rule Act (D.C. Code, sec. 1–141).

(c) The term "District" means the District of Columbia.

(d) The term "District revenues" means District revenues as defined in section 103(10) of the Home Rule Act (D.C. Code, sec. 1–122(10)).

(e) The term "eligible liabilities" means all current liabilities of the District in the general fund, excluding liabilities relating to advance collection of taxes, annual leave due to employees, and interest on loans from the United States Treasury, which current liabilities shall be determined as of September 30, 1980, as reported in the Annual Financial Report of the District as audited by an independent auditor in accordance with generally accepted accounting principles.

(f) The term "Home Rule Act" means the District of Columbia Self-Government and Governmental Reorganization Act, as amended (Public Law 93–198).

(g) The term "Mayor" means the Mayor of the District as provided for by section 421 of the Home Rule Act (D.C. Code, sec. 1–161).

(h) The term "net eligible liabilities" means the aggregate amount of eligible liabilities minus the aggregate amount

of current assets of the general fund of the District determined as of September 30, 1980, as reported in the Annual Financial Report of the District as audited by an independent auditor in accordance with generally accepted accounting principles. Net eligible liabilities equal $184,000,000.

DISTRICT'S AUTHORITY TO ISSUE GENERAL OBLIGATION BONDS TO PAY ELIGIBLE LIABILITIES

SEC. 3. (a) The District is authorized to incur indebtedness by issuing general obligation bonds for the purpose of—

(1) paying eligible liabilities;

(2) reimbursing the general fund of the District for funds expended after September 30, 1980, to pay eligible liabilities;

(3) paying costs incidental to the issuance of the bonds; and

(4) providing the amounts to be paid from the bond proceeds into a reasonably required debt service reserve fund to the extent provided by the act of the Council authorizing the bonds adopted pursuant to section 4 of this Act.

(b) The aggregate principal amount of bonds issued shall not exceed net eligible liabilities of $184,000,000, plus costs incidental to the issuance of the bonds and the amount needed to provide the debt service reserve fund referred to in subsection (a) of this section.

AUTHORITY TO ISSUE BONDS; REDEMPTION PROVISIONS; APPLICABILITY OF HOME RULE ACT PROVISIONS

SEC. 4. (a) The Council, by one or more acts adopted in the manner provided in the Home Rule Act, may authorize the issuance of all or any part of the aggregate principal amount of bonds, not exceeding the amount of the bonds authorized to be issued pursuant to section 3 of this Act. Any such act shall take effect immediately and the provisions of section 602(c) of the Home Rule Act (D.C. Code sec. 1–147(c)) shall not apply thereto.

(b) Any such act shall set forth a plan for the financing of the amount required annually for the payment of the maturing principal of and interest on the bonds thereby authorized, which plan shall identify—

(1) by type all new or increased taxes or charges proposed;

(2) by source, all new or increased revenues anticipated to be applied; and

(3) proposed expenditure reductions or other reasons justifying the availability of any existing District revenues.

(c) The District may reserve the right to redeem any issue of bonds in whole or in part, before maturity in such manner and at such price as may be fixed by the Mayor prior to the issuance of such bonds.

(d) Except as expressly provided for in this Act, the provisions of the Home Rule Act pertaining to the authorization, issuance, and payment of general obligation bonds, including, without limiting the generality of the foregoing, the provisions of section 603(b) of the Home Rule Act (D.C. Code, sec. 47–228(b)), and Charter Amendment Numbered 1 (D.C. Code, secs. 1–181 to 1–187), shall not apply to the authorization, issuance, or payment of the bonds.

PUBLICATION OF BORROWING LEGISLATION

SEC. 5. (a) The Mayor shall publish once in at least one newspaper of general circulation within the District any act of the Council authorizing the issuance of bonds, together with a notice of the enactment thereof in substantially the following form:

"NOTICE

"The following act (published herewith), authorizing the issuance of general obligation bonds for the purpose of paying certain liabilities of the District of Columbia incurred on or prior to September 30, 1980, or to reimburse the District for funds expended after such date to pay such liabilities, has become effective. The time within which a suit, action, or proceeding questioning the validity of such bonds can be commenced, will expire twenty days from the date of the first

publication of this notice, as provided in the District of Columbia Bond Authorization Act of 1981.

_____

Mayor."

(b) Neither the failure to publish the notice provided for in subsection (a) of this section nor any error in any publication thereof shall impair the effectiveness of any act of the Council authorizing the issuance of bonds nor the validity of any bonds issued pursuant thereto.

SHORT PERIOD OF LIMITATION

SEC. 6. At the end of the twenty-day period beginning on the date of the first publication pursuant to section 5 of this Act or the notice of the enactment of an act authorizing the issuance of bonds:

(a) any recitals or statements of fact contained in such act or in the preambles of the titles thereof shall be deemed to be true for the purpose of determining the validity of the bonds thereby authorized, and the District and all others interested shall thereafter be estopped from denying the same;

(b) such act and all proceedings in connection with the authorization of the issuance of such bonds shall be conclusively presumed to have been duly and regularly taken, passed, and done by the District in full

compliance with the provisions of this Act and of all laws applicable thereto; and

(c) the validity of such act and proceedings shall not thereafter be questioned by either a party plaintiff or a party defendant, and no court shall have jurisdiction in any suit, action, or proceeding questioning their validity, except in a suit, action, or proceeding commenced prior to the expiration of such twenty-day period.

ISSUANCE OF BONDS; MATURITY; EXECUTION OF BONDS; DETERMINATION OF TERMS, FORM AND CONTENTS OF BONDS

SEC. 7. (a) At the end of the twenty-day period specified in section 6 of this Act, the Mayor may issue the bonds authorized by the act published pursuant to section 5 of this Act. An issue of bonds is hereby defined to be all or any part of the aggregate principal amount of bonds so authorized. The Mayor may sell any issue of bonds at either public or private sale in such manner as he shall determine to be in the public interest.

(b) The bonds of each issue shall be payable in annual installments beginning not more than three years after the date of such bonds and ending not more than thirty years from such date.

(c) Bonds shall be executed by the facsimile signature of the officers designated by the act of the Council authorizing such bonds, to sign the bonds, with the exception that at least one signature shall be manual. Coupons attached to bonds shall be authenticated by the facsimile signature of the Mayor unless the Council shall provide otherwise. All other matters relating to the terms, form, and contents of bonds shall be prescribed by the Mayor.

SEGREGATION OF PROCEEDS; REPORTS

SEC. 8. (a) The proceeds from the sale of bonds shall be deposited in a special account in a federally insured financial institution in the District, shall be segregated from other funds of the District and shall be expended only for the purpose for which such bonds were authorized to be issued. In the event that any portion of such proceeds is not expended for such purpose, such portion shall be applied only to the payment of annual debt service on the bonds.

(b) Any moneys realized on any investment of the proceeds of bonds shall be credited to such special account and shall be used only—

(1) for the purpose for which such bonds were authorized to be issued;

(2) to pay annual debt service on the bonds; or

(3) to pay the expenses of maintaining such special account.

(c) No moneys shall be withdrawn from such special account without prior certification by the Mayor, or his designee, that such amount will be expended in compliance with the foregoing provisions of this section.

(d) The District shall keep an account of all transactions involving the bond proceeds which shall be subject to audit by the General Accounting Office, the District of Columbia auditor, and by independent auditors appointed by the Mayor.

(e) The District shall report annually to Congress on its use of the proceeds of the bonds and as to its payment of the principal of and interest on the bonds.

BONDS SECURED BY THE FULL FAITH AND CREDIT OF THE DISTRICT

SEC. 9. The full faith and credit of the District shall be and is hereby pledged for the payment of the principal of and the interest on all bonds whether or not such pledge be stated in the bonds or in the act authorizing the issuance thereof.

GENERAL AUTHORITY TO PLEDGE DISTRICT REVENUES TO SECURE BONDS

SEC. 10. (a) An act of the Council authorizing the issuance of general obligation bonds of the District, whether adopted pursuant to this Act or pursuant to the Home Rule Act, may pledge any District revenues as additional security for the payment of the bonds authorized thereby. In such event, such act may contain provisions which may be a part

of the contract with the holders of the bonds thereby authorized—

(1) describing the particular District revenues pledged as additional security for the bonds;

(2) creating a debt service reserve fund or other special funds;

(3) authorizing the Mayor to execute a trust indenture securing the bonds;

(4) vesting in the trustee under such trust indenture such properties, rights, powers, and duties in trust as may be determined necessary, convenient, or desirable;

(5) authorizing the Mayor to enter into and amend such agreements as may be deemed necessary, convenient, or desirable concerning the custody, collection, use, disposition, security, investment, and payment of the bond proceeds and pledged District revenues, and the doing of any act (including refraining from doing any act) which the District would have the right to do in the absence of such agreement;

(6) the remedies of the holders of the bonds in the event of a default; and

(7) authorizing and empowering the Mayor to do any and all other things necessary, proper, or expedi-

ent in connection with the issuance, sale, delivery, securing, and payment of the bonds.

(b) Any provision of article 8 of title 28 of the District of Columbia Code to the contrary nowithstanding, any such pledge of District revenues shall be valid, binding, and perfected from the time when such pledge is made without any physical delivery of the collateral or further act, and the lien of any such pledge shall be valid, binding, and perfected against all parties having claims of any kind in tort, contract, or otherwise against the District irrespective of whether or not such parties have notice thereof. No instrument by which such a pledge is created nor any financing statement need be recorded or filed.

(c) Notwithstanding section 466 of the Home Rule Act (D.C. Code, sec. 47–246), any issue of bonds authorized pursuant to the Home Rule Act which shall be additionally secured by a pledge of District revenues pursuant to this section may be sold by the Mayor prior to the expiration of two years from the last day of the fiscal year of the District during which this Act shall take effect, at either public or private sale in such manner as he shall determine to be in the public interest.

DEBT LIMITATION COMPUTATIONS

SEC. 11. Principal and interest payments due on issued bonds shall not be included in the computation under section

603(b) of the Home Rule Act (D.C. Code, sec. 47–228(b)), for the purpose of determining whether other general obligation bonds or Treasury capital project loans may be issued within the limitation prescribed thereby.

EXEMPTIONS FROM THE APPROPRIATION PROCESS

SEC. 12. The fourth sentence of section 446 of the Home Rule Act (D.C. Code, sec. 47–224) shall not apply to—

(a) amounts obligated or expended from the proceeds (inclusive of accrued interest and premiums) derived from the sale of any bonds;

(b) amounts approved, obligated, or expended for the payment (as to either principal or interest, or both, inclusive of any redemption premium) of any bonds; or

(c) the pledge, transfer, or assignment of any District revenues to secure or otherwise to provide for the payment of any bonds.

TAX EXEMPTION; LEGAL INVESTMENT

SEC. 13. The provisions of sections 485 and 486 of the Home Rule Act (D.C. Code, secs. 47–252 and 47–253) shall apply to all bonds.

EFFECTIVE DATE

SEC. 14. This Act shall take effect on the date of the enactment thereof.

STATEMENT OF ARRINGTON L. DIXON, CHAIRMAN, COUNCIL OF THE DISTRICT OF COLUMBIA

Thank you for the opportunity to appear before this distinguished body today to provide testimony on S. 744, a bill to authorize the District of Columbia to issue and sell general obligation bonds to pay eligible liabilities.

S. 744, which has won the support of the Reagan administration, authorizes the District of Columbia to issue and sell general obligation bonds to the extent of $184 million. The revenue derived from the sale of these bonds will be used to pay an accumulated operating deficit. By enacting S. 744, a potential cash flow problem would be avoided during forthcoming fiscal years and the District would be able to enter the municipal bond market to fund capital projects.

Consistent with the spirit of Home Rule, the District of Columbia is seeking a further extension of its financial powers through the bill under discussion today. Financial independence and control are critical cornerstones to achieving and maintaining a realistic concept of Home Rule government. The managers of the District of Columbia, both elected and appointed, must be provided the discretion to decide what is in the best interest of the District of Columbia from a fiscal point of view, and also provided the financial capability to meet those responsibilities. The granting of bonding authority will improve the ability of the District to manage its finances in the same manner as other state and local governments throughout the nation.

As the Chairman of the Council of the District of Columbia, I can assure you that the Council will act judiciously in exercising this bonding authority. The legislation which the Council will have to enact will be carefully constructed to assure that the sale of bonds is presented in a way that achieves our greatest financial objectives at the lowest possible cost. The Council will require from the Mayor a regular financial statement which explains the use of the proceeds from the sale of the bonds and the payment of principal and interest on the bonds.

I have personally been involved in the initiation of the use of bonding as a tool to solve the District's financial problems, the idea surfaced at hearings held by the Council in September, 1980 on the comprehensive financial plan. At that time many alternatives were considered. I am in favor of the use of bonds because with the necessary legislative controls they can provide funds to pay an operating deficit in a way that does not burden today's residents with yesterday's debts. Also, it enables the District to avoid the drastic options of selling its most valuable assets and increasing taxes when these rates are already extraordinarily high.

The District of Columbia has taken several steps towards a sound system of financial management in the relatively short span of time since the enactment of Home Rule. Two successful audits of the District's finances have taken place. At the same time, a sophisticated financial management system has been designed and implemented. This system will enable the centralized monitoring of spending and revenue collection on a daily basis. Once fully operational. this system will provide the early warnings on overspending or under-collection of revenues which make us better able to address fiscal problems before they become "budget crises".

Another important part of the financial checks and balances that are built into the system is the Council's involvement in the review of budget actions and its ongoing oversight responsibility of a group of agencies. Whenever a budget action is sent to the Council by the Mayor, each committee carefully examines the impact of that action on the agencies under its purview. As part of the process, separate public hearings are held by each committee.

The Council's Committee on Finance and Revenue will continue to serve as a financial watchdog with added responsibilities in this area. The involvement of Councilmember John Wilson as Chairman of the Committee on Finance and Revenue will help to enhance the Council's ability to shape the necessary controls over the use of bonding authority.

In the spirit of Home Rule and in the interest of the fiscal health of the District of Columbia, I urge the Subcommittee to act favorably on S744.

Thank you again for the opportunity to appear and provide testimony on the important matter before you today.

STATEMENT BY J. PAT GALLOWAY, ON BEHALF OF THE GREATER WASHINGTON BOARD OF TRADE

Mr. Chairman, Members of the Committee, thank you for the opportunity to testify today. I am J. Pat Galloway, President of the Greater Washington Board of Trade and in that capacity, speak on behalf of the 1,500 business and professional

firms who are members of the Board of Trade. While the Board of Trade is regional in both its scope and orientation, we have a special interest in the financial health of the District of Columbia. The District of Columbia is the heart of this metropolitan region. Its physical and economic well-being and its capacity to properly manage its financial affairs are of particular significance to the economic health of the entire region.

We have had a long history of involvement with the District Government on fiscal matters, both pre and post Home Rule, including providing loaned executives from our member firms to help improve city service delivery in the public school system and manpower department. We've worked with the city to:

reduce the cost of government while maintaining services,
obtain the present $300 million authorization contained in the charter,
secure a predictable Federal Payment,
receive needed federal support of D.C. pension cost,
expand the city's tax base
and have in the past, when absolutely necessary to the overall health of the District, supported limited tax increases on the business community.

As you are well aware, after the District was granted Home Rule, it was determined that the pre-Home Rule financial records and accounting practices would not allow for an independent audit of the city's books. Since the framers of the Home Rule Charter (Public Law 93-198) envisioned that this new goverment of the District would operate, with certain exceptions, as any other city operates in generating the funds needed for capital improvements, the unauditable condition of the city's books precluded the city's entry into the private bond market since bond issues could not be rated in absence of an independent audit. After the expenditure of significant sums of both District and federal resources through the temporary Commission on Financial Oversight, the first independent audit of the District was completed and released in February of this year. The fiscal year 1980 audit verified that the city had in both pre and post Home Rule days incurred a $388 million deficit. District officials have advised us, as they have advised you, that the city requires an infusion of approximately $184 million in order to finance the cash portion of this already incurred deficit.

Many plans, including the plan before you in S. 744 have been suggested for the financing of these cash needs. Alternatives that have been publicly proposed include such items as: long term borrowing from the federal financing bank, short term borrowing from the United States Treasury over a 7-year span, increasing local taxes in order to generate the needed amount of cash this year and finally, the agreed upon city plan to finance this $184 million cash need through the issuance of long term municipal bonds.

Our Legislative/Fiscal Bureau reviewed all of these proposals to making its recommendation to the Board of Directors to give our qualified support of the plan before you. Our recommendation is based on our careful analysis of the economic impact of the various proposals on the city and thus the region's economy. We ask that you support S. 744 for the following reasons:

A tax exempt investment rated municipal bond issue will have a significantly lower debt service cost than treasury borrowing. The city has reported to us that historically, tax exempt municipal market interest rates are 1 to 2 percent lower than treasury rates.

The savings available to the District take on a greater importance when one recognizes that any further local tax increases, in the absence of any changes in the city's taxing authority, will serve to further diminish the city's revenue base. For the record, we are submitting a copy of our 1980 Comparative Tax Report which analyzes the actual tax burden levied on 6 types of businesses in those jurisdictions comprising the Washington region. In almost every case, the District's tax burdens on business are the highest in the region. It is important to note that our 1980 Comparative Tax Report does not include the $53 million tax increase enacted last year.

The entry of the city into the bond market will help improve the District's financial discipline and management. The analysis performed by bond rating services in determining the credit worthiness of municipal bond issues will add an important new element to the oversight of the District's finances. A new degree of accountability will be mandated by the city's entry into the private bond market since objective measures are used to develop a bond rating.

The objectives of Home Rule are best achieved through private financing of the deficit than through a federal solution. The essence of Home Rule which was granted to the District less than a decade ago, is for local problems to be solved at the local level. In our judgment, local financial problems should be resolved at the local level through a partnership with the federal government. This proposed solu-

tion to the District's immediate cash needs does not require an infusion of federal resources into the District. It does not federally guarantee this bond issue. It is, however, the beginning of a new level of maturity for the still young District government with the city requesting the authority to raise needed funds on the private market rather than through the federal financial umbilical cord.

For the above mentioned reasons, we encourage your support of S. 744 as the most palatable of the alternatives proposed to deal with this problem. However, we would be less than candid, if we did not note the business community's real concern that the debt service associated with this bond issue will not be spread fairly throughout all segments of the community. Our Board of Directors, in adopting our policy, noticed that there were two fundamental considerations. The first is that our support for the city's financing already incurred operating deficits through the bond market is limited to this time only. And second, that since the city envisions these as "double barrelled bonds" with repayment pledged by both the full faith and credit of the District and by a pledged revenue stream, that the real property tax, one of the three largest locally generated revenue sources be used as the pledged revenue stream. Additionally, in order to assure that the debt service is not unduly burdensome to one sector of the community, we believe that the present classified or tiered property tax system in the District should be eliminated and a uniform rate be adopted.

Thank you.

STATEMENT OF FREDA STERN ACKERMAN, EXECUTIVE VICE PRESIDENT, MOODY'S INVESTORS SERVICE

My name is Freda Stern Ackerman. I am Executive Vice President and Director of the Municipal Department of Moody's Investors Service, Headquartered in New York City.

In conjunction with your examination of S. 744, you have asked me to describe the bond rating process for general obligation bonds at Moody's and the comment on deficit financing bond issues which we have rated.

I. INTRODUCTION

As credit analysts, we look to historical trend data in order to assist us in making evaluations as to future performance. This is an established procedure of credit analysis. Whether governmental administrations change or not, observation of trends in the basic areas of general obligation bond analysis provide the foundation for the credit analyst's judgment. Certainly, more than just trend data are looked to in formulating our assessments, but they consititute the core.

The term trend is commonly defined as the general movement over a period of time of a statistically detectable change. That is exactly the kind of measurement we make as credit analysts and is the kind of performance a municipality must demonstrate before its numbers become believeable.

Ideally, a unit of government is able to demonstrate that it is in a sound condition before the incurrence of debt. Within its current financial structure and using current economic conditions as a guide, a unit should have no difficulty in making projections that show budgetary balance can be maintained, supplemented by positive margins available to deal with possible future adversities. As we all know however, ideal conditions do not always exist, and we in fact have assigned investment grade ratings to many situations where less than optimum conditions prevail. The basic reason relates to a unit of government's ability to demonstrate control within its limited resources. Indebtedness derives protection by virtue of the municipality's capability to deal with budget problems in a budgetary context. Until this is achieved, financial health remains elusive.

II. GENERAL OBIGATION BOND ANALYSIS

What is a municipal bond rating?

A municipal bond rating is a judgment of the investment quality of a long-term obligation issued by a state or one of its subdivisions. It is based on an analysis that must ask, first, what has the debtor pledged to pay, and secondly what is the likelihood that it will be able to keep its promises, all of them?

The rating is the essence of the analysis, the synthesis, a shorthand statement of the judgment which is reached. It is a statement about the debtor's condition, the probability that it can and will do what it says regarding the debt. Probability in this context refers to an evaluative assessment of the protections afforded the bondholder rather than a mathematical statement couched in terms of chance and

the cast of the die. The rating is not arrived at through a precisely stated mathematical formula. People in a social context are involved, and in no endeavor yet, has man been reduced to manipulation inherent in mathematical formulas.

The rating is a simple, easy-to-understand classification of the credit risks of a municipal bond. It is a judgment which the market finds to be useful in making comparisons and in maintaining liquidity of capital funds.

The first question asked in the analysis leading to the rating is what has the debtor promised or pledged to pay? Because of the public nature of the issuer, true mortgages and the usual physical security associated with other long-term debt in instruments will be lacking. Aside from pledged concerning time, amount, and mechanics of payment, the central question is—what will the debtor pay the obligation from—what will be the source of funds? The answer determines the questions which will be asked in the analysis, and there are several broad categories of pledges. These are as follows:

1. The general obligation pledge in which the borrower pledges its full faith and credit and unlimited taxing power. This is the broadest form of analysis; the most general, and most traditional.

2. The limited pledge involving a single tax or a specific governmental revenue. A variant of the special fund doctrine, the limited tax pledge involves use of a governmental power, the power to tax.

3. The enterprise or quasi—enterprise revenue pledge. Another variant of the special fund doctrine, this produces the true revenue bond, and the analysis leans heavily on longstanding corporate experience.

4. The lease pledge whereby funds derive immediately from resources other than those of the issuer but in which the issuer does something to justify payments which include debt service.

5. A pledge, usually disguised, of someone else's resources.

There are, of course, almost infinite variations, combinations, and permutations of these pledges. They cover the spectrum from an outright pledge to discharge the obligation almost to a denial that it even exists. They are inspired by all the legal and constitutional limitations placed on debt usage over the last 130 years.

Having determined the pledge, the analyst examines the general obligation bond or the revenue bond or the lease bond or backup bond. After the first two categories, he is increasingly in the hands of legal interpretations and hopes the lawyers are friendly and in substantial agreement with one another.

In general obligation bond analysis a substantial number of determinants present themselves but generally they may be subsumed under four heads: debt, financial, governmental, and economic.

Debt analysis involves

1. Debt policy: the uses, purposes, and planning of debt issuance, as well as the type instrument used, including short-term instruments.

2. Debt structure: adequacy of plans for debt retirement; the relation between rate of retirement and purpose of debt, resources of the community, and existing and future debt needs.

3. Debt burden: gross and net debt related to resources and comparison with other communities' overlapping debt.

4. Debt history and trend: the record as to defaults, refunding of maturing bonds, funding of operating deficits; rapidity of debt growth relative to purposes for which it has been incurred.

5. Prospective borrowing: authorized and unissued bonds; adequacy of capital programming; obsolescence or inadequacy of capital plant; existing debt structure.

6. Debt security: the examination of the specific pledge for the repayment of the debt being issued; the relationship of the revenue pledged to the total budget and to the debt servicing obligation created.

Under financial analysis we find these categories

1. The current account: the year-end relation of current liabilities to available cash; promptness in disposing of casual deficits; devices to keep deficits from accumulating; if accounting is revenue accrual—the adequacy of reserves for uncollectible accounts; the liquidity of current account cash and uncollected taxes should equal demand liabilities outstanding.

2. Revenue system: adequacy of property tax base; trend of assessed value, equalization ratio, levy, and collections; other components of revenue system—source, base, rates, yields, diversity, cyclical stability, adequacy of aid from other governments, and cash flow requirements.

3. Expenditure analysis: vulnerability to mandated expenditures; relation of debt service and other fixed costs such as salaries and pensions to total expenditures.

4. Budget analysis: adequacy of planning, appraisal of past performance on revenue and expenditure estimates, current trend of financial operations.

5. Financial administration: assessment practices; tax collection procedures; enforcement procedures, financial planning as evidenced by budgeting, reporting, services.

6. History of financial operations: long-term trend of revenues and expenditures; secular and cyclical patterns.

Government study includes

1. Organization: diffusion of responsibilities; degree of professionalism; sufficiency of powers to discharge functions.

2. Services: provision for essential services to perpetuate economic base.

3. Intergovernemtnal factors: the pyramid of governmental units, conflicts and duplications; complementary other units which drain off resources or impede planning.

4. Administrative performance: conscientious administrators who promote confidence through standing and experience; availability of audits, budgets, annual reports, capital planning documents; land use plans.

The final category—economic—involves among others

1. The identity and natural resources: geographic and locational advantages; natural catastrophe; natural resources; size and land use characteristics.

2. Population and wealth, the labor factor: population characteristics; wealth levels (family income and per capita full value); housing characteristics; new construction values.

3. Economic structure and capital: types of employment, industry and occupation; major employers; relation to SMSA; evidence of industrial decline or population shifts; transportation and its relation to the economic structure, and finally,

4. Economic performance and prospects: the secular trend of the economy; the cyclical trend; seasonal and random variations.

The question is how these are put together to determine a rating. Simply it is a process of examining each area of information and their interrelations and making a judgment modified as necessary by empirical evidence and experience. There is no way to cram them all into a single formula, activate the computer, and pick up the answer. The stumbling block is weighting.

Most analysts agree ability to pay is an important part of a good rating. The analyst is well down the road to reaching a judgment on this by an examination of debt burden and wealth levels. They are quantifiable rather precisely; and they lend themselves to comparisons.

Willingness to pay is another accepted principle. Again, revenues, wealth, and burden may be related to provide a judgment, which may be modified by history and other indicators.

Probably, most disagreements on ratings spring from different weights attached to the factors in analysis by different analysts.

I would like to leave this general area with a question—under the worst circumstances possible with revenues inadequate to meet all of an issuer's needs, where would the bondholders stand in the line to collect? I suspect they have not been given the true answer, which will have to await the worst circumstances and a series of lawsuits to settle. Is the true answer known with any certainty? Unknowns of this kind are what cloud our knowledge of what weights to attach to the many factors of analysis.

I want to concentrate on the new problems facing the general obligation bond. The general obligation bond—limited or unlimited tax—has always carried an aura of mysterious comfort about it. The issuer, having taxing power, would pay because above all it wanted to protect its credit. The flexibility in managing financial affairs would enable it to come up with the money if a temporary problem arose. And, if it should somehow fail in that area, the bondholder still enjoyed the protection of bringing suit. The governmental unit could be forced to levy and collect the taxes to meet the terms of the bond contract. The municipal analyst therefore worked with a safety margin that in retrospect was unheard of to the corporate analyst. Ultimately, the municipal analyst said, you sue and force the tax collections, because the school district, for example, facing insolvency does not fold up and sell off its assets in partial satisfaction of creditors' claims. Thus, wealth, a long-term future, a reasonable history of financial management, and moderate debt levels headed the list of what the municipal analyst looked for in the general obligation bond.

What happened to shatter this comfortable illusion? State legislatures have repealed bond convenants. A moratorium on the payment of notes was enacted. New municipal bankruptcy laws have been passed. Local government officials, and, in

certain cases, the courts have stated that noteholders can wait, we'll keep the schools operating.

A partial result of all this is that issuers will have to demonstrate beyond doubt that they can meet debt and all other obligations. Debt now apparently is a competitor of payment, and if this is truly the case, the future of the municipal market may be dark.

The analyst's best approach right now is to think of a general obligation bond in the same way as a net revenue bond. A pledge of gross revenues has never been really credible to me because the enterprise has to operate to generate revenues, and to operate, it has to pay its employees and operating costs. In the case of the net revenue bond, the analyst investigates every potential threat to incursion on net revenues. This now has to be done for general obligation bonds. The element of trust has been impaired. The issuer will have to provide for every conceivable liability that can compete with debt service.

There is no refuge right now in the general obligation bond concept. The analyst must determine that sufficient revenues are generated net of expenses to pay whatever bonded debt obligations have been incurred and are proposed.

Some vital considerations are the following:

1. The budget must be balanced without the use of tricks or mirrors. The use of last year's surplus to keep this year's tax rate increase down is certainly legitimate, but postponing payment of a current liability is not. Is there a concerted effort to eliminate deficits through the budget mechanisms or by other means?

2. Borrowing must be geared to the state of the economy. If the economy is expanding, debt properly planned may expand with it. But a stabilized economy inhibits debt incurrence, and a declining economy requires the utmost care in debt planning.

3. The debt ratio is more critical than ever, particularly its interpretations. As expressed, net overall debt as a percent of estimated full value, a figure of 10 percent may now be considered high.

4. A city, for example, cannot engage in any extensive program of income redistribution. If it seeks to finance these programs out of its own tax base, it can drive out those who are called on to bear the heavier burden, heavier at least compared with alternatives.

5. The property tax remains the basis of security for local debt issues. The base should be protected and equitably assessed. Efforts should be made to resist further exemptions. If the legislature wants to subsidize somebody, let it raise state taxes and make cash payments or cash reimbursements, instead of heavy subsidies at local unit's financial cost and out of the local unit's financing base.

6. The analyst is committed to searching out all liabilities, to determine that expenses are met before matching debt service requirements with the net remaining. The real significance of what is going on is that debt holders are being told that they are last in line, or, at best, must jostle for position. Debt holders are facing changes in the rules which are developing at their expense. One of these liabilities some governments may be confronting is for employees retirement. These are liabilities that accrue daily. Chances are there is an unfunded pension fund liability which it has been easier to ignore than to raise taxes to cover. Localities must stop asking the bondholder to compete with this liability once it is recognized, or when increasingly organized municipal labor forces the issue.

The factors in general obligation bond and debt analysis have not changed from the elements I described earlier, but the emphasis has. The bondholder is an anonymous, faceless, apolitical entity who basically is seeking conservation of capital and the going rate of return. If the debt holder is asked to compete annually with other financial liabilities for payment, the job of analysis differs from that of the preferred position that has been implied and, in some cases, explicity stated. And in the difference the financial officer is going to have to be meticulous in accounting and reporting. Right now, there is less trust and more skepticism than formerly, because large-scale mis-management has done a lot of harm to the market generally.

There is nothing arbitrary, mysterious, or capricious about a rating. It is merely a rationalization and a simplification based on the best analysis the credit analyst can perform.

III. DEFICIT AND LIABILITY FINANCING

Let me now turn to the more specific topic at hand, the financing of deficits and other liabilities.

Financial operating imbalances are not an uncommon occurrence in the realm of state and local government finance. Budget officers are being increasingly chal-

lenged to make their annual forecasts in a climate of economic uncertainty, volatile financial market conditions, the vagaries associated with the appropriation and funding levels of intergovernmental aids and a propensity toward initiative and judicial challenges to local taxing authority. The continued achievement of balanced operations and the financial stability maintained by the vast majority of local governments attest to the overwhelming dedication to fiscal integrity regardless of adversity.

The appearance of deficits is not usually an indication of mismanagement or a disregard of obligations but rather can either indicate an unexpected setback or evidence of a more serious structural imbalance between resources and commitments. In analyzing the credit implications of a deficit, the analyst must first determine its underlying cause. Unexpected occurrences are often accompanied by a financial drain that is not easily accommodated within the confines of a single year's budget. Economic downturn, especially the temporary closing of a community's major industrial employer and largest source of income tax revenue or the permament shutdown by a major property taxpayer, has recently upset many municipal budgets. Midyear labor settlements, particularly those imposed under binding arbitration, have posed a similar strain as have unfavorable court judgments, most notably for taxpayer refunds resulting from alleged property tax inequalities. Imbalances arising from a chronic situation of excessive spending commitments relative to the revenue base are often concealed in poor budgeting practices. Typically, revenue over estimation and expenditure under estimation are used to produce a balanced budget. As conditions deteriorate future budgets may additionally include such items as an "expected prior year's surplus" that does not ultimately materialize and intergovernmental aids under proposed programs that have yet to be adopted.

Regardless of cause, an operating deficit can threaten a community's financial stability if the underlying condition goes unaddressed. In the case of an unexpected deficit, it is important for the analyst to determine whether there was sufficient contingency planning in the budget process and to what degree flexibility existed to curtail spending in certain areas in order to meet pressing needs elsewhere. Chronic budget imbalance generally requires a much more comprehensive overhaul of financial operations. Plans to increase revenues and/or cut expenditures must be accompanied by a commitment to tighten budgetary practices. In the most difficult situations, communities have relinquished some of their financial powers to independent oversight agencies or other levels of government in order to restore some level of credibility and credit worthiness.

After scrutinizing the cause of a deficit and the programs undertaken to minimize the chances of its recurrence, the analyst must study the government's plan to eliminate the accumulated deficit. The statutes regulating local government finance in many states require that any operating deficit must be provided for in the ensuing year's budget. When deficits are of a manageable magnitude or where supplementary revenues can be enacted and dedicated to deficit reduction, this is generally considered the most responsible course of action. However, in the case of a large deficit or in a situation with minimal revenue flexibility, the requirement to eliminate the deficit in a single year may exacerbate the already weakened financial position, causing pressures and bringing about successsively larger year-end deficits. Budgetary set asides over several years, where legally permissible, are often a favorable deficit reduction alternative, provided that sufficient actions were taken to minimize the chance of deficit recurrence.

The final area of deficit analysis, and the one which is particularly pertinent to a discussion of S. 744, is deficit financing. The cash implications of an accrued deficit vary substantially from one situation to the next. The cash flow patterns of many localities are such that they must borrow in anticipation of revenue collection even though funds are maintained on a balanced or surplus basis. Conversely, the favorable cash patterns enjoyed by other localities permit an operating fund to carry a sizeable deficit without resorting to outside financing. Communities may also be able to carry a deficit by accelerating certain receipts or delaying certain payments. Deficits that require financing are sometimes financed internally through interfund transactions, also without resorting to external sources. Typically, funds holding cash that is not legally restricted or segregated lend it to the deficit ridden fund. While a potentially satisfactory and inexpensive means of deficit finance, interfund borrowings have at times been treated casually, without an accompanying cure for the underlying problems. This can result in an undermining of the financial health of the entire organization.

External deficit financing is what is now being proposed for the District of Columbia. Such borrowings generally follow a period where internal adjustments

and interfund transaxtions proved inadequate. There are several broad categories of deficit financing vehicles and some recent examples of each.

Borrowing in anticipation of one year's revenues is a financing approach appropriate in those cases where deficit elimination is planned over the short-term. Budget notes in New York State are a vehicle specifically created for such purposes. Providence, Rhode Island, had a substantial operating deficit for which it issued tax anticipation notes to be paid in the next year from property taxes that were increased specifically for such purpose. The deficit was equal to approximately one-third of the city's total budget resources, a magnitude that led to political delays in adopting the proposal. These delays, the magnitude of the deficit and the immediate cash implications led Moody's to reduce the city's general obligation bond rating from A 1 to Baa in February 1981. Detroit, Michigan, which is required to eliminate any operating deficit in the following year's budget, has in recent years issued tax anticipation notes prior to fiscal year-end in anticipation of next year's taxes. The city has in each year been able to pay notes at maturity but despite severe cutbacks and economies has been unable to simultaneously accommodate the elimination of the prior year's deficit and balance the current year's operations. The city's bonds had been rated Baa largely reflecting the need to cope with volatile economic cycles. The rating was revised to Ba in August 1980 as it became apparent that the mechanisms used to rectify past imbalances were no longer sufficient. Detroit is currently in the process of finalizing a comprehensive fiscal recovery package that links a voted tax increase, employee concessions and a $113 million deficit bond issue.

Longer term financing of deficits does give the government an extended period in which to make what are often fundamental changes in financial operations and tends to ease the burden of deficit elimination by stretching repayment over a period of years. Significant long-term deficit financing bond issues have been undertaken by a number of states and localities when it was perceived that the magnitude of the problems to be addressed could not be rectified within a short time period. The State of Connecticut ran successive annual operating deficits from 1968 to 1971. Short-term obligations repaid in the ensuing year were initially utilized but the attempts at quick deficit paydown caused further strain. The state eventually sold two deficit funding bond issues, totaling $244 million in 1973-74; these bonds matured through 1981. The state also enacted a temporary sales tax increase at the same time and also dedicated the substantial portion of any future surpluses to debt retirement. The state's Aaa rating was maintained through this funding period but another deficit financing in 1975 together with the hesitance to impose a needed broad based tax eventually led to a 1975 downgrading to Aa. Subsequently, in 1976 the rating was again revised to A 1.

The Commonwealth of Massachusetts had in 1975, following a period of economic downturn coupled with escalating costs, the need to finance $450 million of total deficit of $531 million. The combination of recessionary trends and their budgetary implications together with the magnitude of the deficit financing resulted in a rating revision from Aa to A 1 in 1975. The bonds were paid down over a five year period through 1980 with increased liquor and cigarette tax revenues specifically dedicated to debt repayment.

The State of Delaware sold $30 million of 30-month bonds in 1977 to finance a deficit resulting from both economic conditions and a revenue-expenditure imbalance. Citing these conditions, Moody's lowered the rating, in stages from Aa to Baa 1. Of the total financing, $11 million was paid off prior to maturity with the remainder retired through May 1979. The demonstration of strength through rapid-deficit retirement and implementation of needed revenue measures has led to the restoration of an A 1 rating in 1980.

New York City's deficit financing took many forms. The city had for years in effect bonded a portion of its deficit by inclusion of certain operating expenses within its capital budget. The portion of the deficit that remained in the operating fund had been financed by the accumulation and rollover of a short-term indebtedness that grew to $4.5 billion by 1975. The inability to maintain market access for note rollover led to the subjecting of some $2.9 billion of notes maturing between December 1975, and March 1976, to the Moratorium Act, and to the eventual funding of some $4.8 billion of deficits through bonding by the Municipal Assistance Corporation (MAC). The inability to repay its obligations at maturity led to Moody's downgrading of the city's general obligation bond rating to a default level of Caa. The current B rating, in effect since 1977, is in large measure a reflection of the long and arduous process of budgetary overhaul that is still required to achieve recurring budgetary balance. The magnitude of the accumulated deficit and the severity of the underlying budgetary problems led to the creation of the separate issuing entity, MAC, and a legal structure that severed a revenue stream from the

city and effectively assigned it directly to MAC. The recovery plan strategy is to achieve budgetary balance by holding tax rates stable while seeking outside fiscal assistance and implementing austerities. This approach required the long 30-year repayment of MAC debt and has resulted in the City taking 6 years to balance its operating budget in accordance with generally accepted accounting principles. The investment grade rating on MAC's general obligation bonds of Baa 1 is based on the legal strengths of the pledge to bondholders.

The Chicage School Finance Authority, Illinois, was created in 1980 specifically to bond out the accumulated deficit and the operating cash requirements of the Chicago Board of Education. The board has accumulated a deficit which it carried internally in part, but which was also partially financed within the board's annual tax anticipation borrowings. The credit quality of these tax notes drastically diminished when it became understood that new borrowings were requisite to meet current payments.

A succession of interim financings was arranged but ultimately a newly created state authority specifically empowered to engage in deficit bonding was required. The School Finance Authority's $573 million bond issuance in 1980 funded all of the Board's deficits and cash flow requirements. Debt service payments on Authority bonds are to be made from a property tax levy deducted from the Board's taxing powers and assigned to the Authority. Again, as with New York City, there was no new revenue infusion and as a result deficit bond repayment has been stretched over a full 30-year period. The Board's general obligation bonds are rated B in view of the uncertainties of restoring recurring budget balances. The Authority's bonds are rated Baa 1 as the legal separation and revenue pledge provide basic security but at the same time this fragmented governmental structure and the relationship to the still ailing Board represent an underlying weakness.

The City of Chicago, Illinois, issued $149 million of 12-year notes in May 1980, $94 million of which were for deficit financing. The city's deficit is in part attributed to unforeseen events and certain unsound budgetary practices. These problems and their cash implications were cited in a downgrading of the city's general obligation bond rating from Aa to A in 1980. The city was able to issue the deficit bonds on the strength of its own pledge, and repayment has been structured over a relatively short period of time. The city has apparently moved quickly to eliminate the cause of past imbalances by correcting the budgetary problems which principally related to management of internal service funds and by a temporary increase in its operating tax rate. The city is levying additional taxes for the repayment of the deficit notes.

IV. CONCLUSION

Moody's has never rated any obligations of the District of Columbia nor have we ever been formally requested to do so. At several points, where proposals for bond issuances have been discussed, we have had some preliminary contact with District officials and we have seen some of the most recent documentation including the latest audit and the Mayor's July 1980 Financial Plan. However, having never gone through a credit analysis of the District, our comments regarding the financing proposed under S. 744 can only be of a general nature.

The cause of the District's accumulated deficit is not fully known to us at this time but it is generally understood that it arises from some combination of successive budget imbalances and the non-recognition of certain costs and obligations. The size and nature of proposed spending reductions, the uncertainty of local revenue measures and the hope for an increase in the Federal Payment, present challenging analytic questions, questions which are heightened by our lack of familiarity with the District. The magnitude of the proposed deficit financing must be better understood relative to the size of the total accumulated deficit. While this has been an openly discussed point of contention by those more intimately familiar with the cash requirements, we might only suggest that once a deficit financing program is undertaken any subsequent upward revisions in the financing requirements can only undermine confidence in the total program.

The possible 30-year maturity of the bonds is not dissimilar from funding undertaken elsewhere; however, as previously stated such a stretching out is usually an admission of the severity of underlying weakness. The programs of both MAC and the Chicago School Finance Authority were rated as possessing characteristics of a sound investment but in both cases the issuers were constituted as entities that were legally separated from the financially troubled local government. Moreover, in both cases, the financial plans and fiscal affairs of the troubled government were required to be reviewed and approved by independent monitors.

The magnitude of the proposed deficit financing for the District, if it is to be undertaken by the District itself, will present a difficult analytical challenge. To be examined will be the adequacy of the funding program and the revenue pledge to the repayment of the debt as well as the procedures and regulations to be instituted not only to prevent deficits from recurring but also to ensure sound financial operations during the life of the debt to be issued.

It is much too premature to be able to assess whether debt of this kind can feasibly be issued and accepted by the marketplace. All of the facts are not yet known. However, since we, at Moody's, do place emphasis on past trends, the first step in our analytical process, should we be asked to rate the District's debt, will be an attempt to more fully understand the causal factors contributing to past and current problems and an examination of new structures put in place to prevent a recurrence.

Appendix—Bond Rating Definitions

Aaa

Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edge." Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

Aa

Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may be of greater amplitude or there may be other elements present which make the long-term risks appear somewhat larger than in Aaa securities.

A

Bonds which are rated A possess many favorable investment attributes and are to be considered as upper medium grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment sometime in the future.

Baa

Bonds which are rated Baa are considered as medium grade obligations, i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

Ba

Bonds which are rated Ba are judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

B

Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of interest and princial payments or of maintenance of other terms of the contract over any long period of time may be small.

Caa

Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

CA

Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

C

Bonds which are rated C are the lowest rated class of bonds, and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

CON. (. . .)

Bonds for which the security depends upon the completion of some act or the fulfillment of some condition are rated conditionally. These are bonds secured by (a) earnings of projects under construction, (b) earnings of projects unseasoned in operating experience, (c) rentals which begin when facilities are completed, or (d) payments to which some other limiting condition attaches. Parenthetical rating denotes probable credit stature upon completion of construciton or elimination of basis of condition.

Those bonds in the Aa, A, Baa, Ba and B groups which Moody's believes possess the stongest investment attributes are designated by the symbols Aa1, A1, Baa1, Ba1, and B1.

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